TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1961

No. 83

HATTIEBELLE O. SIMONSON, TRUSTEE IN BANKRUPTCY, ETC., ET AL., PETITIONERS,

vs.

R. C. GRANQUIST, DISTRICT DIRECTOR OF INTERNAL REVENUE, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR CERTIORARI FILED APRIL 22, 1961
CERTIORARI GRANTED JUNE 5, 1961

No. 16073

United States
Court of Appeals
for the Ninth Circuit

HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy of the Estate of Max L. Druxman, Bankrupt,

Appellant,

vs.

R. C. GRANQUIST, District Director of the Internal Revenue Service,

Appellee.

Transcript of Record

Appeal from the United States District Court for the District of Oregon.

Phillips & Van Orden Co., 4th & Berry, San Francisco, Calif.—6-10-60

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF ATTORNEYS

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For Appellant.

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United States Attorney,
Portland, Oregon,

For the Appellee.

Form 2317 (March 1957)

U. S. Treasury Department
Internal Revenue Service

Proof of Claim for Internal Revenue Taxes

In the United States District Court
for the District of Oregon

Docket No. B-41801

In the Matter of

MAX L. DRUXMAN dba Druxman's Jewelers,
2805 N.E. 33rd Avenue, Portland, Oregon.

Type of Proceeding: Liquidating Bankruptcy

CLAIM OF THE UNITED STATES FOR INTERNAL REVENUE TAXES

The undersigned officer of the Internal Revenue Service, a duly authorized agent of the United States in this behalf, being duly sworn, deposes and says that:

1. Max L. Druxman is justly and truly indebted to the United States in the sum of $5,821.69 with interest thereon as hereinafter stated;

2. The said debt is for taxes due under the internal revenue laws of the United States as follows:

Kind of Tax and Period	Amount Due	Remarks Tax Lien Filed	Date Tax Lien Arose
Income Tax—1949	$285.00*	10/31/57	9/6/57
Penalty	128.27		
Interest to 11/29/57			
Income Tax—1950	299.00*	10/31/57	9/6/57
Penalty	134.61		
Interest to 11/29/57	120.28		
Income Tax—1951	554.00*	10/31/57	9/6/57
Penalty	237.17		
Interest to 11/29/57	189.63		
Income Tax—1952	595.00*	10/31/57	9/6/57
Penalty	255.60		
Interest to 11/29/57	167.97		
Income Tax—1953	595.00*	10/31/57	9/6/57
Penalty	255.60		
Interest to 11/29/57	132.27		
Income Tax—1954	572.00*	10/31/57	9/6/57
Penalty	241.20		
Interest to 11/29/57	89.97		
Income Tax—1955	590.00*	10/31/57	9/6/57
Penalty	189.96		
Interest to 11/29/57	57.40		

*Plus interest on this amount at 6% per annum from 11/29/57 to the date of payment.

3. No part of said debt has been paid and the same is now due and payable at the Office of the District Director of Internal Revenue;

4. There are no set-offs or counterclaims to said debt;

5. Except for the statutory tax liens which arose on the dates above stated; the United States does not hold, to the deponent's knowledge or belief, any security or securities for said debt;

6. No note or other negotiable instrument has been received for said debt or any part thereof, nor has any judgment been rendered with respect to said debt; and

7. Said debt has priority and must be paid in full in advance of distribution to creditors as and to the extent provided by law:

In Bankruptcy Act Proceedings see Sections 64, 77e, 199, 337(2), 455, and 659 of the Bankruptcy Act (11 U.S.C. 104, 205(e), 599, 737(2), 855, and 1059),

In Other Proceedings see Section 3466 of the Revised Statutes (31 U.S.C. 191). Also, attention is invited to Section 3467 (31 U.S.C. 192) with respect to the personal liability of any executor, administrator, or other person who fails to pay the claims of the United States in accordance with their priority.

/s/ W. E. PUTNAM,

Chief, Special Procedures Section, Office of the District Director of Internal Revenue, 827 N.E. Oregon Street, Portland 14, Oregon.

Subscribed and Sworn to before me this 29th day of November, 1957.

[Seal] /s/ DORIS BARNES,
Notary Public.

My commission expires April 30, 1958.

[Endorsed]: Filed December 3, 1957, Referee.

[Endorsed]: Filed October 9, 1959, U.S.D.C.

United States District Court
For the District of Oregon

In Bankruptcy—No. B-41801

In the Matter of

MAX L. DRUXMAN,

Bankrupt.

TRUSTEE'S OBJECTIONS TO THE CLAIM OF R. C. GRANQUIST, DISTRICT DIRECTOR OF INTERNAL REVENUE SERVICE

To: Honorable Folger Johnson, Referee in Bankruptcy of this Court.

Comes now Hattiebelle O. Simonson, Trustee of the above-entitled estate and objects to part of the claim of R. C. Granquist, District Director of Internal Revenue Service upon the following grounds:

1. That $22.13 of this alleged claim represents interest which arose subsequent to the filing of the petition in voluntary bankruptcy on file herein.

2. That $1,441.21 of this alleged claim represents penalties for non-payment of taxes.

Wherefore your Trustee prays for an order disallowing those parts of said claim as set out hereinabove.

/s/ HATTIEBELLE O. SIMONSON.

Duly verified.

[Endorsed]: Filed July 9, 1958, Referee.

[Title of District Court and Cause.]

REFEREE'S FINDINGS AND CONCLUSIONS

Statement of the Facts

The bankrupt was in the business of a small retail jeweler and the trustee was able to realize more than $8,000 upon liquidation of the business assets. This sum is sufficient to pay all tax claims and expenses of administration.

The Director of Internal Revenue has filed various claims in the bankruptcy proceeding for income, employment and excise taxes accruing prior to bankruptcy. All of these have been paid by the trustee with the exception of the penalties and post-bankruptcy interest included in claim No. 18. The trustee objected to this part of such claim and the matter has been submitted to the referee upon written briefs.

Claim No. 18 in the amount of $5,821.69 includes penalties of $1,442.41 and post-bankruptcy interest at 6% upon $4,932.41. The tax itself with interest to the date of bankruptcy was paid pursuant to order entered May 22, 1958, leaving unpaid post-bankruptcy interest in the sum of $182.49.

The taxes included in claim No. 18 were assessed against Druxman September 6, 1957, and a statement of tax due issued ten days later. Druxman filed his voluntary petition in bankruptcy on October 18, 1957. The notice of tax lien was filed by the Bureau of Internal Revenue on October 31, 1957.

The government is asserting a position as a secured creditor by virtue of its assessment lien rather than claiming as a priority creditor under Section 64 of the Bankruptcy Act.

There are three issues raised by the briefs:

1. Does the failure to file the notice of tax lien prior to bankruptcy make such lien invalid against the trustee?

2. Does Section 57(j) of the Bankruptcy Act prohibit the payment of penalties included in a claim based on a tax lien that arose prior to bankruptcy?

3. Is post-bankruptcy interest allowable to date of payment where the claim is based on a tax lien that arose prior to bankruptcy?

Conclusions of Law

Where a federal tax claim is not supported by a lien arising prior to bankruptcy, it is well settled that it is given a priority position under Section 64a (4) of the Bankruptcy Act, and that Section 57(j) prohibits the payment of penalties included in such claim. Nor is post-bankruptcy interest payable on such a claim. City of New York v. Saper, 336 U.S. 328, 93 L. ed. 710.

Where, however, a lien arose prior to bankruptcy and the tax claim is filed as a secured claim under Section 67, there is conflict and confusion in the law throughout the nation that can only be resolved by decision of the U. S. Supreme Court or by legis-

lative action on the part of Congress. Since this is a question of federal bankruptcy law rather than state law, it is to be hoped that such action will soon be forthcoming to provide uniformity in this matter throughout the federal courts. In the meantime each circuit is free to choose its own path.

Let us consider the first issue. Is a federal tax lien perfected as against the trustee of the bankrupt's estate where the tax has been assessed before bankruptcy, but the notice of the tax lien has not been filed until after the filing of the bankruptcy petition? It is admitted that a lien arises upon assessment of the tax and that such lien is valid unless the trustee fall within the group excepted by the Internal Revenue Code. 26 U.S.C.A., Section 6323(a), provides that the lien "* * * shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed * * *"

Since the trustee is neither mortgagee nor pledgee, is he a purchaser or judgment creditor under this statute? Gradual changes in the Bankruptcy Act have shown a trend to strike down secret liens and to increase the power of the trustee for the benefit of general creditors. When the Ninth Circuit, however, was confronted with the question in the case of United States v. England, 226 F. 2d 205, (1955), it chose to base its decision on the case of U. S. v. Gilbert Associates, 345 U.S. 361, 97 L. ed. 1071, 73 SCT 701, which held that the words "judgment creditor" in Section 3672 of the Internal Revenue

Code of 1954 (26 U.S.C.A., Section 6323), were used in the "usual, conventional sense of a judgment of a court of record." The Gilbert case did not involve a bankruptcy question but only the priority of a municipal tax lien over a federal where the notice of the federal lien had not been filed until after the attachment of the municipal lien which was in the nature of a judgment under state law. The England case then held that, since the Internal Revenue Code had reference only to a creditor holding a judgment obtained by judicial proceedings in the conventional sense, a trustee in bankruptcy is not a judgment creditor.

This same result was reached in a recent decision of a U. S. District Court in New Jersey. In re: Fidelity Tube Corporation, 167 F. Supp. 402 (1958).

Although a trustee in bankruptcy finds greater favor as a subsequent purchaser for value under Oregon statutes and court decisions than under the law of many other states, the trustee is still not a "purchaser" under Section 3672. In the case of U. S. v. Hawkins, 228 F. 2d 517, (9 CCA), (1955), the court said that an attaching creditor may not rely on a local Alaska statute, giving him the status of a purchaser, to claim the benefits of a favored class under Section 3672, as "purchaser" in that section usually means one who acquires title for a valuable consideration in the manner of vendor and vendee. "Taxation statutes should be construed to apply uniformly throughout the country and there is nothing to indicate that Alaskan taxpayers were

intended to get a benefit unavailable to the rest of the United States."

New York Terminal Warehouse Co. v. Bullington, 213 F. 2d 340 (5 CCA), (1954), holds that a trustee fails to qualify as a bona fide purchaser for value.

We must conclude, therefore, that the United States is entitled to claim the position of a secured creditor even though the notice of the tax lien was not filed until after the filing of the bankruptcy petition. Demand had been made upon the taxpayer and he had failed to make prompt payment.

As a lien claimant is the government entitled to demand from the bankrupt's estate not only the tax itself, but also the penalties included in the lien? The answer is to be found in the scope accorded to Section 57(j) of the Bankruptcy Act which provides:

"Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law."

Does Section 57(j) apply only to unsecured claims or should it be interpreted to cover secured claims as well and hence to modify Section 67(b) which

provides that a statutory tax lien shall be valid against the trustee? The government has shown no pecuniary loss and it would seem more equitable to interpret Section 57(j) to prohibit the payment of penalties out of the bankruptcy estate even though such penalties are part of a tax lien arising prior to bankruptcy.

One of the two primary purposes of the bankruptcy law is to accomplish an equitable distribution of the assets among creditors. To allow penalties in addition to the taxes themselves would not achieve this result. Penalties are to prevent non-payment of taxes, acting as a deterrent to the taxpayer, but to permit their payment out of the bankruptcy estate is to penalise the innocent general creditors rather than the bankrupt. If penalties are to be paid at all, they should be paid by the bankrupt himself out of funds not belonging to his estate. It has been held, however, that although taxes are non-dischargeable, penalties and post-bankruptcy interest are not part of such taxes and would be discharged by the granting of a discharge to the bankrupt. In re: Mighell, 168 F. Supp. 811, (D. C. Kansas 1958).

Various district courts, struck with the equities of the situation, have held Section 57(j) to be controlling and have refused to allow the payment of penalties in spite of the existence of a tax lien perfected prior to bankruptcy. Among these are In re: Lykens Hosiery Mills, 141 F. Supp. 895 (DC SD NY 1956), In re: Hankey Baking Co., 125 F. Supp.

673 (DC WD Pa. 1954), In re: Burch, 89 F. Supp. 249 (D. C. Kans. 1948), In re: Parchem, 166 F. Supp. 724 (DC Minn. 1958).

Three circuit courts, however, including our Ninth Circuit, have taken the opposite position and allowed the payment of penalties, holding that Section 57(j) did not apply where the government's lien had been perfected prior to bankruptcy. In re: Knox-Powell-Stockton Company, 100 F. 2d, 979 (9 CCA 1939), Commonwealth of Kentucky, etc., v. Farmers Bank & Trust Company, 139 F. 2d, 266 (6 CCA 1943), Grimland v. U. S., 206 F. 2d 599 (10 CCA 1953).

Since we are bound by the decision of the Ninth Circuit in the absence of any action by the U. S. Supreme Court, it must be held that the government is entitled to the penalties included in claim No. 18.

Considering next the question of post-bankruptcy interest, it is the general rule that interest ordinarily ceases to run on both secured and unsecured claims, including tax claims, as of the date of the filing of the bankruptcy petition. Certain exceptions to this rule have been recognized in the case of secured claims.

In Beecher v. Leavenworth State Bank, 192 F. 2d 10 (9 CCA 1951), the court said:

"As a general rule, interest stops on both secured and unsecured claims upon the date of filing the petition in bankruptcy. Sexton v. Dreyfus, 219 U. S.

339, 31 S. Ct. 256, 55 L. Ed. 244. This is a rule of convenience which has developed from a century and a half of English bankruptcy practice. The basis of the rule is to allow orderly administration of the bankrupt's estate; matters must be brought to a halt at a time certain and this date allows the rendition of accounts without doubt as to any future claims for interest. Certain peculiar considerations require the application of the rule to interest on secured claims. Otherwise, the equity of unsecured creditors is in danger of being wiped out by interest claims of secured creditors who have extended credit at high rates during the debtor's transitional period of financial embarrassment prior to bankruptcy. Further, the period of administration may be lengthy, especially when, as here, there has been a failure to appraise the redemption value of the farm-debtor's property.

"A contrary rule for secured claims would also discourage contests by the unsecured creditors of secured claims. They would be forced to abstain so that the administration of the estate could be wound up quickly; and the trustee would have every motive to make quick sales in order to bring administration to a halt shortly.

"Two qualifications of the rule that interest on secured claims stops at the date of bankruptcy have been recognized:

"1. If the estate turns out to be fully solvent, it has been thought more equitable to apply the surplus to creditors' claims for interest rather than re-

turning the money to the debtor. Johnson v. Norris, 5 Cir., 190 F. 459, L.R.A.1915B, 884.

"2. If securities in the creditor's possession pledged as collateral yield income, this amount has been charged with the secured creditors' claims for interest. Sexton v. Dreyfus, supra.

"Except as state above, the only time in which the majority of modern cases have allowed interest after bankruptcy on secured claims is when the courts have discovered equitable reasons for doing so. Vanston, etc., Committee v. Green, 329 U.S. 156, 67 S. Ct. 237, 91 L.Ed. 162; Pacific States Corp. v. Hall, 9 Cir., 166 F. 2d 668."

Later cases added a third exception, holding that, where the security is sold for more than the sum of principal and interest due, the secured creditor is entitled to post-bankruptcy interest to the date of payment. Jefferson-Standard Life Ins. Co. v. U. S., 247 F. 2d 777 (9 CCA 1957), Palo Alto Mutual Savings and Loan Ass'n. v. Williams, 245 F. 2d 77 (9 CCA 1957), In re: Macomb Trailer Coach, 200 F. 2d 611 (6 CCA 1953).

It is claimed by the United States that it is entitled to post-bankruptcy interest as a secured creditor under this third exception, since its lien is "upon all property and rights to property, whether real or personal." 26 USCA Section 6321. It is further claimed that the lien should be treated as specific rather than general pursuant to United States v. New Britain, 347 US 81, 98 L. ed. 520, 74 S CT 367

(1954). This case, however, dealt only with liens on real property. It would seem that if this third exception is to apply to tax liens at all, it should apply only to the extent of the net value of the real property belonging to the bankrupt's estate and subject to such lien. The assets in the present case are all from the sale of personal property.

Section 67c of the Bankruptcy Act shows an intent to distinguish between liens on real and personal property as it provides that the payment of expenses of administration and wage claims shall take precedence over liens for taxes or debts owing to the United States on personal property, except as to property actually seized by the government before bankruptcy.

The cases cited by the government are not specifically in point as they deal with consensual liens held by a vendor, mortgagee or the like. The only case coming to my attention which clearly supports the government's position in regard to post-bankruptcy interest is In re: Parchem, cited supra in support of the disallowance of penalties. Two later district court cases, however, have taken the opposite position, holding that post-bankruptcy interest does not accrue on tax claims, whether liened or unliened. In re: Young, 171 F. Supp. 317 (W. D. Wisc., 1959), In re: Cameron, 166 F. Supp. 400 (S. D. Calif. 1958).

The latter case reversed the decision of the Referee who had held that the government was entitled

to post-bankruptcy interest pursuant to the ruling of the Ninth Circuit in Palo Alto Mutual Savings & Loan Assn. vs. Williams, supra. Both the Young and Cameron cases discuss the history and reasons for the denial of post-bankruptcy interest and conclude that a tax lien, being non-consensual, does not place the government in the class of secured creditors entitled to benefit from the third exception to the rule against payment of such interest. In considering this third exception in the Cameron case, Judge Yankwich stated:

"The situation thus contemplated was intended to protect the creditor in his security which, on liquidation, produced enough to satisfy the encumbrance. And herein lies the real distinction between the situation which the Court had before it in that case and a tax lien.

"An encumbrance is placed upon the property voluntarily by a debtor as security for his debt after agreement with the creditor. By doing so, the debtor authorizes not only the satisfaction of the debt out of the sale of the particular property, but agrees to the payment of any deficiency that might arise after the sale and that other property he may own may be subjected by execution to the payment of a deficiency judgment.

"In whatever legal proceeding the secured creditor takes to satisfy his debt, the debtor cannot, except in cases involving fraud, question the validity of the instrument or the amount of the debt which

it was given to secure. Prima facie, at least, the presumption is that it was voluntarily given for a debt actually owed. At most, the question might arise about any deductions for payments made. So the instrument itself settles most of the problems as to genuineness, due execution and the amount of the debt. This is not so in the case of a tax lien. The tax lien is merely an assertion by the Government that so much tax remains unpaid. The filing of the lien does not determine the tax as against the taxpayer. And, in any subsequent proceedings, whether brought by the Government to foreclose the lien or by the taxpayer who pays the assessment and sues for a refund or enjoins the Government after liquidation or seizure, or by the Government of the United States when it institutes the action to collect, the validity of the entire assessment and its exact amount are justiciable questions. Rightly. For otherwise, the taxpayer would be at the mercy of the humblest agent of the revenue service who capriciously levied an assessment. From long judicial experience, I know of assessments running into hundreds of thousands of dollars, which, after judicial inquiry, were found to have no foundation except a misinterpretation of the law by the officer levying the assessment concurred in by the Commissioner. So there are many cogent reasons for allowing post-bankruptcy interest in a case where a specific piece of property is impressed by the debtor with a mortgage or trust deed and appropriated, after mutual agreement between him and his creditor, to the payment of a specific debt, when, upon

liquidation, a surplus exists. But there is no justification for a distinction between ordinary taxes and taxes which are made the subject of a lien, which comes into being unilaterally and may be disputed as to validity and amount by the taxpayer in administrative and judicial proceedings, warranting the courts to depart from the salutary principle of disallowing interest in bankruptcy, except in certain extraordinary instances." (Footnotes omitted.)

Referee in Bankruptcy Rufus W. Reynolds of North Carolina followed similar reasoning in the Matter of G. N. Childress, reported at page 12 of the January, 1959, Journal of the National Association of Referees in Bankruptcy:

"Unlike liens based upon a voluntary contract entered into between individual parties, the tax liens here do not arise out of any transaction contributing a prior economic benefit to the bankrupt. Where the transaction is in the ordinary course of business, the lienholder extends something of value to his debtor and thus indirectly to others dealing with the debtor. Considerations of fair play thus impel the allowance to the lienholder, as against unsecured lesser creditors, of whatever he had the foresight to secure to the extent that his security will permit, including interest until payment. A taxing agency, however, has made no investment in the estate of the debtor, and when it seeks to recover interest it seeks to earn a return without having extended any economic benefit or taken any

economic risk. Therefore, while it is appropriate that general creditors should yield to secured creditors who have bargained for security itself sufficient to provide for the payment of interest, no similar appropriateness appears in forcing them to yield to a tax lien."

It is understood that the government has appealed the Childress case, involving both penalties and post-bankruptcy interest, to the Fourth Circuit after the District Judge affirmed the Referee's decision. See also In re Lykens Hosiery Mills, supra, which refused to allow post-bankruptcy interest on a tax lien claim.

In many cases the liquidation of the assets may take a considerable time, and in some cases no assets which be realized were it not for the efforts of the trustee and his attorney over that period of time. Often the debtor has terminated his business some time before bankruptcy, disposing of the physical assets and leaving only disputed claims and accounts receivable for the trustee. To allow this necessary delay to give the government a substantial windfall in post-bankruptcy interest at the expense of the other creditors would be highly unjust. The delay in distribution is an act of the law and a necessary incident to the settlement of the estate. No class of creditors should be allowed to profit at the expense of another because of a delay for which the law is responsible. United States vs. Edens, 189 F. 2d 876, 878 (4 CCA 1951) aff'd

342 U.S. 912; In re Industrial Machine & Supply Co., 112 F. Supp. 261, 263 (W.D.Pa. 1953).

In re Cameron, supra, involving the question of post-bankruptcy interest alone (although Judge Yankwich clearly indicated that he was opposed to the allowance of penalties also), has been appealed to the Ninth Circuit and this matter, upon which no circuit court has yet squarely ruled, should be settled in this circuit by the end of the year. Should the Fourth Circuit reach an opposite result in the Childress case, one of them will undoubtedly be carried to the U. S. Supreme Court to put the dispute to rest in a common grave. In the meantime I am constrained to follow the rules of equity, the spirit of the Bankruptcy Act and the weight of the majority rule on this specific question and sustain the trustee's objection to the claim of the United States to post-bankruptcy interest.

The trustee is directed to prepare an order based on these findings and conclusions, for the payment of the penalties included in claim No. 18 and disallowing all post-bankruptcy interest.

Entered at Portland, Oregon, this 14th day of August, 1959.

/s/ FOLGER JOHNSON, JR.,
Referee in Bankruptcy.

[Endorsed]: Filed August 14, 1959, Referee.

[Title of District Court and Cause.]

ORDER

This matter came regularly on for hearing on the trustee's objections to the claims of R. C. Granquist, District Director of the Internal Revenue Service, for tax penalties in the sum of $1,442.41 and for post-bankruptcy interest, said claims being included in Claim No. 18, in the files and records of this bankruptcy.

The trustee was represented by Asher & Cramer and Fred A. Granata, her Attorneys of record; R. C. Granquist was represented by Clarence E. Luckey, United States Attorney; Edward F. Georgeff, Assistant United States Attorney; John D. Picco, Special Assistant to Regional Counsel, Internal Revenue Service, and Jack T. Fuller, Attorney of Regional Counsel, Internal Revenue Service.

Both the trustee and the claimant submitted written briefs on which hearing was held. The Court, after due consideration of said written briefs, made its findings of fact and conclusions of law and entered same herein.

Now, therefore, based on said findings of fact and conclusions of law, it is hereby ordered as follows:

1. That the tax penalties claimed in Claim No. 18 in the amount of $1,442.41, be and the same hereby are allowed and the trustee be and she hereby is authorized and directed to pay said tax

penalties to R. C. Granquist, District Director of the Internal Revenue Service.

2. That post-bankruptcy interest claimed in Claim No. 18 be and the same hereby is disallowed.

Dated and entered this 20th day of August, 1959.

/s/ FOLGER JOHNSON, JR.,
Referee.

[Endorsed]: Filed August 20, 1959, Referee.

[Title of District Court and Cause.]

CERTIFICATE OF REFEREE ON PETITIONS OF THE DISTRICT DIRECTOR OF INTERNAL REVENUE AND THE TRUSTEE FOR REVIEW OF REFEREE'S ORDER ALLOWING PENALTIES BUT DISALLOWING POST-BANKRUPTCY INTEREST ON A FEDERAL TAX LIEN CLAIM

To the Honorable Judges of the Above-Entitled Court:

Folger Johnson, Jr., the Referee in Bankruptcy in charge of this proceeding, hereby makes this his certificate on the petition of the District Director of Internal Revenue and on the petition of the trustee, Hattiebelle O. Simonson, for review of the Referee's order entered August 20, 1959, wherein it was ordered that the trustee pay to the District Director of Internal Revenue the tax penalities in the amount of $1,442.41, included in Claim No. 18

in this proceeding, and further ordering that post-bankruptcy interest on the entire claim be disallowed.

Questions Presented

The only questions presented are whether

(1) The Referee erred in holding that the District Director of Internal Revenue in the Ninth Circuit is entitled to the payment of penalties included in a claim based on a Federal tax lien that arose prior to bankruptcy in spite of the provision in Section 57(j) of the Bankruptcy Act prohibiting the payment of penalties.

(2) The Referee erred in holding that post-bankruptcy interest is not allowable to date of payment of such Federal tax lien claim even though the lien arose prior to bankruptcy and proceeds from the sale of the bankrupt's assets were sufficient to pay such interest.

Facts

There is no dispute as to the facts. On December 3, 1957, the District Director of Internal Revenue filed his claim for income taxes in the amount of $5,821.69, including penalties and interest, and specifying that additional interest was claimed to the date of payment of such claim. Penalties included therein amounted to $1,442.41. This claim was registered in the proceeding as Claim No. 18.

The tax itself with interest to the date of bankruptcy was paid pursuant to order entered May 22,

1958, leaving unpaid the aforesaid penalties and post-bankruptcy interest in the sum of $182.49. The trustee filed an objection to the penalties and post-bankruptcy interest included in such claim. At the hearing thereon, it was agreed that this was solely a question of law and that the matter should be submitted to the Referee on briefs.

Discussion

A further statement of the facts and discussion of the law is set forth in the Referee's Findings and Conclusions entered August 14, 1959. It should be noted that In re: Cameron, 166 F. Supp. 400 (S.D. Calif. 1958) has been appealed by the District Director of Internal Revenue to the Ninth Circuit Court of Appeals. The only question involved in this case is the payment of post-bankruptcy interest on a Federal tax lien claim.

The Fourth Circuit Court of Appeals recently ruled against the District Director of Internal Revenue on the question of both penalties and post-bankruptcy interest on Federal tax lien claims, and this case may now be on appeal to the United States Supreme Court. U.S. vs. Harrington, decided August 6, 1959 (CCH Bankruptcy Law Reports, Paragraph 59587).

Papers Submitted

Transmitted herewith are the following papers:

1. Proof of claim No. 18, filed December 3, 1957, by the District Director of Internal Revenue.

2. Trustee's objections to said claim.
3. Notice of hearing on trustee's objections.
4. Memorandum in support of Internal Revenue claim.
5. Memorandum Brief of the United States.
6. Memorandum Brief of the trustee.
7. Supplemental Brief of the United States.
8. Referee's Findings and Conclusions.
9. Order of Referee Allowing Penalties and Disallowing Post-Bankruptcy Interest.
10. Stipulation for Extension of Time.
11. Motion for Extension of Time.
12. Order Allowing Extension of 30 Days to File Petition for Writ of Review.
13. Petition of District Director of Internal Revenue for Review of Referee's Order.
14. Petition of Hattiebelle O. Simonson, Trustee, for Review of Referee's Order.
15. Order for Stay Pending Review.

Dated at Portland, Oregon, this 8th day of October, 1959.

Respectfully submitted,

/s/ FOLGER JOHNSON, JR.,
Referee in Bankruptcy.

[Endorsed]: Filed October 9, 1959, U.S.D.C.

In the United States District Court
for the District of Oregon

No. B-41801

In the Matter of

MAX L. DRUXMAN,

Bankrupt.

ORDER

This matter came on upon the certificate of Referee Folger Johnson, Jr., a Referee in Bankruptcy of this Court, on the petitions of the District Director of Internal Revenue and the Trustee for review of the Referee's order allowing penalties but disallowing post-bankruptcy interest on a Federal tax lien claim duly made and entered herein by the said Referee on August 20, 1959, wherein it was ordered as follows:

1. That the tax penalties claimed in Claim No. 18 in the amount of $1,442.41, be and the same hereby are allowed and the trustee be and she hereby is authorised and directed to pay said tax penalties to R. C. Granquist, District Director of the Internal Revenue Service.

2. That post-bankruptcy interest claimed in Claim No. 18 be and the same hereby is disallowed.

The Court having considered the Referee's certificate aforesaid, the respective briefs of the parties, the findings and conclusions of said Referee

and the law of the matter, and being fully advised in the premises;

It Is Hereby Considered, Adjudged and Ordered that the aforesaid order of Folger Johnson, Jr., as Referee aforesaid, dated August 20, 1959, be and the same is hereby approved, ratified and affirmed in all respects.

Dated February 16, 1960.

/s/ WILLIAM G. EAST,
United States District Judge.

[Endorsed]: Filed February 16, 1960, U.S.D.C.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: R. C. Granquist, District Director of the Internal Revenue Service.

To: Clarence E. Luckey, United States Attorney.

Notice is hereby given that Hattiebelle O. Simonson, Trustee of the above-entitled estate, hereby appeals to the United States Court of Appeals for the Ninth Circuit from that part of a certain order entered in this proceeding on February 16, 1960, by Hon. William G. East, a Judge of the United States District Court for the District of Oregon, allowing to R. C. Granquist, claimant, the tax penalties claimed in claim number 18 on file in this proceeding.

Dated this 11th day of March, 1960.

ASHER & CRAMER,

By /s/ FRED A. GRANATA,
Of Attorneys for Trustee-Appellant.

Service of copy acknowledged.

[Endorsed]: Filed March 11, 1960, U.S.D.C.

[Title of District Court and Cause.]

STATEMENT OF POINTS UPON WHICH TRUSTEE-APPELLANT INTENDS TO RELY UPON APPEAL

Comes now the Trustee, Hattiebelle O. Simonson, and files the following statement of points upon which she intends to rely upon appeal to the United States Court of Appeal for the Ninth Circuit:

1. That the Court erred in allowing the tax penalties claim by R. C. Granquist, District Director of the Internal Revenue Service, said penalties being claimed in claim number 18 in the files and records of this proceeding.

ASHER & CRAMER,

By /s/ FRED A. GRANATA,
Of Attorneys for Trustee-Appellant.

Service of copy acknowledged.

[Endorsed]: Filed March 11, 1960, U.S.D.C.

CERTIFICATE OF CLERK

United States of America,
District of Oregon—ss.

I, R. DeMott, Clerk of the District Court of the United States for the District of Oregon, do hereby certify that the foregoing documents consisting of Proof of Claim No. 18 by the District Director of Internal Revenue; Trustee's Objections to Claim No. 18; Notice of Hearing on Trustee's Objections; memorandum in support of Internal Revenue claim; memorandum brief of the United States; memorandum brief of the Trustee in Bankruptcy; supplemental brief of the United States; referee's Findings and Conclusions; order of referee allowing penalties and disallowing post-bankruptcy interest; stipulation for extension of time; motion for extension of time; order allowing extension of 30 days to file petition for review; petition of District Director of Internal Revenue for review; petition of trustee in bankruptcy for review; order of stay pending review; supplement to memorandum brief of the trustee; certificate of referee on petitions for review; clerk's minute entry of order affirming order of referee; order of the Honorable William G. East, District Judge, ratifying and affirming order of referee dated August 20, 1959; notice of appeal; designation of contents of record on appeal; statement of points upon which appellant will rely; supplemental designation of contents of record on appeal; and Clerk's bankruptcy docket sheet constitute the record on appeal from an order of said

court in a certain bankruptcy cause therein numbered B-41801, in the matter of Max L. Druxman, bankrupt, in which Hattiebelle O. Simonson, Trustee in Bankruptcy is the appellant and R. C. Granquist, District Director of Internal Revenue is the appellee; that said record has been prepared by me in accordance with the designations of record on appeal filed by the appellant and the appellee and in accordance with the rules of this court.

In Testimony Whereof I have hereunto set my hand and affixed the seal of said court in Portland, in said District, this 13th day of April, 1960.

[Seal] R. DeMOTT,
Clerk.

By /s/ J. W. DAVIS,
Deputy.

[Endorsed]: No. 16878. United States Court of Appeals for the Ninth Circuit. Hattiebelle O. Simonson, Trustee in Bankruptcy of the Estate of Max L. Druxman, Bankrupt, Appellant, vs. R. C. Granquist, District Director of the Internal Revenue Service, Appellee. Transcript of Record. Appeal from the United States District Court for the District of Oregon.

Filed April 19, 1960.

Docketed April 29, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals for the Ninth Circuit.

[fol. 31a]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 16878

HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy of the Estate of Max L. Druxman, Bankrupt, Appellant,

vs.

R. C. GRANQUIST, District Director of the Internal Revenue Service, Appellee.

[fol. 32] Before: Chambers, Hamley and Merrill, Circuit Judges.

MINUTE ENTRY OF ARGUMENT AND SUBMISSION—January 6, 1961

This cause coming on regularly for hearing and submission Mr. Fred A. Granata, argued for the Appellant and Mr. Karl Schmeidler argued for the Appellee and thereupon, the court ordered this cause submitted for consideration and decision.

[fol. 33]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MINUTE ENTRY OF ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT—February 1, 1961

Ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the clerk and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion rendered.

[fol. 34]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 16,878

HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy of the Estate of Max L. Druxman, Bankrupt, Appellant,

vs.

R. C. GRANQUIST, District Director of the Internal Revenue Service, Appellee.

Upon Appeal from the United States District Court for the District of Oregon.

OPINION—February 1, 1961

Before: Chambers, Hamley and Merrill, Circuit Judges.

Per Curiam:

This appeal is taken by the trustee of a bankrupt estate from the judgment of the District Court affirming an order of the Referee in Bankruptcy which allowed the United States a lien claim against the bankrupt estate in the sum of $1,442.41 for penalties on unpaid federal taxes.

Two questions are presented by this appeal.

The first question concerns the significance of the fact that although the lien of the United States arose prior to the filing of a petition in bankruptcy, notice of such lien was not filed until after the filing of the petition in bankruptcy. The trustee contends that under § 6323 of the Internal Revenue Code of 1954, 26 U.S.C. § 6323, the lien of the United States under these circumstances is invalid.

Section 6323 provides that the tax lien of the United States "shall not be valid as against a mortgagee, pledgee, purchaser or judgment creditor until notice thereof has been filed" in certain specified public offices.

[fol. 35] Section 70 of the Bankruptcy Act, 11 U.S.C. § 110, provides in part:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

The trustee contends that under § 70 he is by operation of law made a judgment creditor of the bankrupt; that under § 6323 of the Internal Revenue Code, as a judgment creditor, the lien of the United States is rendered invalid as to him.

The Supreme Court has interpreted § 6323 as limiting the class of persons who take priority over the unrecorded tax liens of the United States to judgment creditors (or purchasers, mortgagees or pledgees) in the conventional and ordinary sense of the words. United States v. Gilbert Associates, 1953, 345 U.S. 361; United States v. Security Trust and Savings Bank, 1950, 340 U.S. 47, 52.

The precise question presented by the instant case was presented to this court in United States v. England, 9 Cir., 1955, 226 F.2d 205. We there held that a trustee in bankruptcy could not, in the light of the Supreme Court's construction of the section, claim the status of judgment creditor under § 6323. Other courts have reached the same result. In re Fidelity Tube Corporation, 3 Cir., 1960, 278 F.2d 776; Brust v. Sturr, 2 Cir., 1956, 237 F.2d 135; see In re Tailorcraft Aviation Corporation, 6 Cir., 1948, 168 F.2d 808.

We adhere to our ruling in United States v. England and accordingly reject this contention of the trustee.

The second question presented by this appeal is whether a claim of the United States for penalties on unpaid taxes, upon which claim a lien arose prior to bankruptcy, is barred by § 57(j) of the Bankruptcy Act, 11 U.S.C. § 93:

> "Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall

[fol. 36] not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law."

While the courts have divided upon this question, this court has held that § 57(j) does not apply to secured claims. In re Knox-Powell-Stockton Company, 9 Cir., 1939, 100 F.2d 979. To the same effect are United States v. Mighell, 10 Cir., 1959, 273 F.2d 682; Kentucky v. Farmers Bank, 6 Cir., 1943, 139 F.2d 266. Cases contrary to this court's position are: United States v. Harrington, 4 Cir., 1959, 269 F.2d 719; United States v. Phillips, 5 Cir., 1959, 267 F.2d 374.

We adhere to our ruling in Knox-Powell-Stockton and accordingly reject the contention of the trustee that § 57(j) invalidates the secured claim of the United States in this matter.

Affirmed.

HAMLEY, Circuit Judge (concurring):

Under section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C.A. § 6323(a), a tax lien of the United States is not valid against a "judgment creditor" until notice thereof has been filed. The notice of the lien here in question was not filed until after the bankrupt's property came into the possession or control of the bankruptcy court. Thus, if the trustee stands in the position of a judgment creditor within the meaning of section 6323, the lien is not valid as to the trustee.

Under section 70(c) of the Bankruptcy Act, 11 U.S.C.A. § 110(c), a trustee in bankruptcy is deemed to be vested as of the date particular property comes into the possession or control of the court, with "all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists." In my view this statute states as clearly as words can speak that a trustee is to be treated *as if* he were a judgment creditor, although obviously he is not one.

As pointed out in the majority opinion, several courts, including this one, have denied the trustee this section [fol. 37] 70(c) status. They have done so because in United States v. Gilbert Associates, 345 U. S. 361, 364, it was stated that section 3672(a) of the Internal Revenue Code, 56 Stat. 798, 26 U.S.C.A. (1946 ed.) § 3672(a), which was similar to section 6323(a) of the Internal Revenue Code of 1954, used the words "judgment creditor" in "the usual conventional sense of a judgment of a court of record, since all states have such courts."

This statement was made in Gilbert Associates in rejecting a contention that a New Hampshire statute which declared a tax assessment to be in the nature of a judgment had the effect of giving city tax liens judgment creditor status under the then section 3672(a). The Supreme Court thus denied to the states and local governments the right to appropriate to themselves by statutory fiat a defense against United States liens which the United States originally intended to be applicable only with respect to ordinary judgment creditors.

But the Supreme Court did not say, and had no reason to say, that Congress could not make available to trustees in bankruptcy a defense which it originally made available only to judgment creditors. The defense having been created by act of Congress, the same legislative body was free to extend its benefits however it pleased. I am thus in full agreement with the very exhaustive dissenting opinion of Judge Kalodner, joined in by Judge Hastie, filed in In re Fidelity Tube Corporation, 3 Cir., 278 F.2d 776, petition for writ of certiorari pending.

If the question discussed above were now before this court for the first time I would accordingly vote to reverse. Since, however, this court adopted a contrary view in United States v. England, 9 Cir., 226 F.2d 205, and Congress may, if it chooses, overturn that ruling for the future by enacting clarifying legislation, I am content to note the above views by way of a concurring opinion.

[File endorsement omitted]

[fol. 38] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 16878

HATTIEBELLE O. SIMONSON, ETC., Appellant,

vs.

R. C. GRANQUIST, ETC., Appellee.

JUDGMENT—Filed and Entered February 1, 1961

Appeal from the United States District Court for the District of Oregon.

This Cause came on to be heard on the Transcript of the Record from the United States District Court for the District of Oregon and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

[fol. 38a]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MINUTE ENTRY OF ORDER DENYING PETITION FOR REHEARING—March 13, 1961

On consideration thereof, and by direction of the Court, It Is Ordered that the petition of appellant, filed March 2, 1961 and within time allowed therefor by rule of court, for a rehearing of above cause be, and hereby is, denied.

[fol. 39] Clerk's Certificate to foregoing transcript (omitted in printing).

No. 17066

United States Court of Appeals

for the Ninth Circuit

UNITED STATES OF AMERICA,

Appellant,

vs.

RICHARD D. HARRIS, Trustee for Alaska Telephone Corporation,

Appellee.

Transcript of Record

Appeal from the United States District Court for the Western District of Washington, Northern Division

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

NAMES AND ADDRESSES OF COUNSEL

Attorneys for Appellant:

THOMAS R. WINTER,
223 U. S. Courthouse,
1010 Fifth Avenue,
Seattle, Washington.

CHARLES P. MORIARTY &
JACOB A. MIKKELBORG,
1022 U. S. Courthouse,
1010 Fifth Avenue,
Seattle, Washington.

Attorney for Appellee:

DONALD A. SCHMECHEL,
Attorney for Richard D. Harris, Trustee
1010-1411 Fourth Avenue Building,
Seattle, Washington.

In the District Court of the United States for
The Western District of Washington
Northern Division

No. 41632

In the Matter of

ALASKA TELEPHONE CORPORATION,
Debtor.

NOTICE OF FILING PETITION FOR REVIEW

To: Richard D. Harris, Trustee for Alaska Telephone Corporation; and Donald A. Schmechel, Attorney for Richard D. Harris, Trustee:

You, and Each of You, will please take notice that the United States of America will file a Petitition for Review in the above-entitled cause, with the Honorable Van C. Griffin, Referee-Special Master, on February 18, 1959, a copy of which Petition is hereto annexed and made a part of this Notice.

/s/ CHARLES P. MORIARTY,
United States Attorney.

/s/ JACOB A. MIKKELBORG,
Assistant United States Attorney,

/s/ THOMAS R. WINTER,
Special Assistant to the Regional
Counsel, Internal Revenue Service.

[Title of District Court and Cause.]

PETITION FOR REVIEW

To: Honorable Van C. Griffin, Referee-Special Master.

The petition of the United States of America respectfully represents:

I.

Your petitioner, United States of America, is now and at all times herein mentioned was a sovereign and corporate body politic. The debtor is justly and truly indebted to the United States for taxes due under the Internal Revenue laws of the United States, as set forth in the verified claims of the United States filed on its behalf.

II.

On February 9, 1959, your Honor, as Referee-Special Master, entered an order herein, determining the liability for taxes of the United States, providing as follows:

"On due proceedings had, the Plan of Corporate Reorganization herein provided for the payment to the United States of $57,000.00 in full for its tax claim, which was duly certified by the Secretary of the Treasury and he did not reject said Plan within ninety (90) days, as provided by law, and therefore he is conclusively presumed to have accepted it and said sum has been duly paid to the United States of America and the Trustee and the assets of the estate and the Debtor are fully discharged from any and all claims of the United States for taxes, penalties and interest."

The said order was based on Findings of Fact and Conclusions of Law, finding and holding in substance:

1. That the Secretary of the Traasury did not properly file a notice of rejection of the plan of reorganization, as amended, with respect to the claims of the United States for taxes, as provided in Section 199 of the Bankruptcy Act;

2. That interest on the amounts deposited with the United States under an offer in compromise made prior to the reorganization proceeding by the debtor should be credited against the Government's claim for taxes;

3. That the United States is not entitled to post-bankruptcy proceeding interest on its tax claims which were liens on the debtor's property prior to said insolvency proceedings;

4. That the United States is not entitled to post-bankruptcy proceedings penalties on its tax claims which were liens on the debtor's property prior to the insolvency proceedings;

5. That the United States is not entitled to interest on the total assessments ten days after issuance of notice and demand, to and including September 30, 1955, the date the petition in the proceedings was filed.

III.

The United States of America respectfully assigns the following specifications of error in said Findings of Fact entered February 9, 1959, by the Honorable Referee-Special Master:

1. That the Referee erroneously determined that the evidence adduced by the hearing before said Referee was sufficient to support his finding that the order of the United States District Court of August 28, 1958,

requiring notice of rejection or acceptance of the Trustee's proposed plan, as amended, was duly served upon the Secretary of the Treasury, or was sufficient to determine the date of said service effective to commence running of the 90-day period within which acceptance or rejection according to the terms of the said order must be filed; (Referee's Finding of Fact I)

2. That the Referee erroneously determined that the acceptance or rejection of the Trustee's plan of reorganization, as amended, was improperly filed with the Clerk of the United States District Court, Western District of Washington, and erroneously concluded that the notice of rejection should have been filed with the Referee-Special Master, rather than with the Clerk of said United States District Court; (Referee's Finding of Fact II)

3. That the Referee erroneously determined that the notice of rejection was improper and of no effect by virtue of the fact that it was signed by the Acting Secretary of the Treasury without any showing or affirmation of his authority or capacity to so act, and without printing his name below his signature subscribed thereon, and that said irregularities, if any, were material matters of substance; (Referee's Finding of Fact III)

4. That the Referee erroneously determined that the notice of rejection was not effectively filed on December 26, 1958, within the 90 days specified by the order of the United States District Court Judge entered November 5, 1958, and Section 199 of the Bankruptcy Act, as amended; (Referee's Finding of Fact II)

5. That the Referee erroneously determined that the notice of rejection was improper and of no effect by

virtue of the fact that the notice of rejection by the Acting Secretary of the Treasury did not bear the name of an attorney for said Acting Secretary and his post office address, or the address of the Acting Secretary of the Treasury; (Referee's Finding of Fact III)

6. That the Referee erroeneously determined that the said notice of rejection by the Acting Secretary of the Treasury failed to comply with Section 199 of the Bankruptcy Act, as amended; (Referee's Findings of Fact II and III)

7. That the Referee erroneously determined that the Trustee of the debtor corporation is entitled to credit on the basis of interest on the sum deposited by the debtor corporation, prior to the Trustee's appointment, to secure an offer in compromise made by said corporation prior to institution of the bankruptcy proceedings in this cause, and that said Referee erroneously determined that interest accrued at six per cent in the sum of $3,863.81, or at any rate and amount; (Referee's Finding of Fact VI)

8. That the Referee erroneously determined that the conditional tender of the sum of $57,000.00 discharged all liability for taxes, interest, and penalities, thereby making unnecessary the determination of the correct tax liability, including penalties and interest on the assessments (designated by the Referee as compound interest), and post-bankruptcy proceeding interest on the said assessments until paid in full. (Referee's Finding of Fact VII)

IV.

The United States of America respectfully assigns the following specifications of error in said Conclusions of Law entered by the Honorable Referee-Special

Master, together with Findings of Fact on February 9, 1959:

1. That the Referee erroneously concluded that the claim of the United States of America has been paid by virtue of tender of the sum of $57,000.00, and that the United States of America has no further claim against the Trustee, the funds in his hands, or the debtor corporation; (Referee's Conclusion of Law 1.)

2. That the Referee erroneously concluded that Section 57(j) of the Bankruptcy Act, as amended, prohibits payment and collection of penalties from bankrupt estates after institution of bankruptcy proceedings where the tax claims, including penalties, are secured by liens perfected prior to filing of the petition under Chapter X proceedings, as in this cause; (Referee's Conclusion of Law 2.)

3. That the Referee erroneously concluded that interest is not allowable on the assessments duly made pursuant to the Internal Revenue laws of the United States, and erroneously concluded that authorities cited by said Referee are controlling of the issue as to interest in this cause; (Referee's Conclusion of Law 3.)

4. That the Referee erroneously concluded that the claim of the United States is diminished by reason of the deposit of a sum under an offer in compromise and interest on such sum deposited to secure said offer in compromise at any rate or amount based on such deposit; (Referee's Conclusion of Law 4.)

5. That the Referee erroneously concluded that interest accrued subsequent to commencement of insolvency proceedings should not be paid from the assets of the estate where the interest is based on assessments supported by liens perfected prior to commencement of

said proceedings, as provided by Section 57(j) of the Bankruptcy Act or other provisions thereof. (Referee's Conclusion of Law 4.)

V.

The Referee-Special Master's Order Determining Liability for Taxes of the United States is erroneous in that:

1. It purports to order that the plan of reorganization was approved and accepted by the United States of America upon the purported failure of the Secretary of the Treasury to reject said plan within 90 days, as provided by law, and further purporting to order that the claims for taxes, penalties and interest have been paid by the subsequent tender of a certified check in the sum of $57,000.00;

2. It fails to allow the claims of the United States in the total sum of $65,336.79 plus interest thereon at the rate of six per cent per annum from the dates of notice and demands, as provided by law, and until paid, except as to the sum of $182.86, which tax liability was not assessed until February 8, 1956, and notice and demand not made until after insolvency proceedings, or until January 27, 1956;

3. It fails to find and conclude that Julian A. Baird, as Acting Secretary of the Treasury, did properly certify by virtue of and pursuant to the provisions of Section 199 of the Bankruptcy Act that he rejected said plan of reorganization, as amended, with respect to the claims of the United States for taxes within the time properly allowed by law, and that the said plan, as amended, providing for the full payment to the United States of its taxes in the sum of $57,000.00 is rejected and not binding upon the United States of America;

4. It fails to allow and order paid post-bankruptcy interest on the tax claims and prior liens of the United States of America;

5. It fails to allow and order paid penalties assessed which were liens on the debtor's property prior to the bankruptcy proceedings, as provided by law;

6. It fails to enter the findings, conclusions and order as requested by the United States of America, claimant.

Wherefore, your petitioner prays that the Referee-Special Master certify to the Judge of this Court and transmit to the Clerk the record in said proceedings, as provided in the Bankruptcy Act, as amended.

United States of America

/s/ CHARLES P. MORIARTY,
United States Attorney.

/s/ JACOB A. MIKKELBORG,
Assistant United States Attorney.

/s/ THOMAS R. WINTER,
Special Assistant to the Regional Counsel,
Internal Revenue Service.

Affidavit of Service by Mail attached.

[Endorsed]: Filed Feb. 13, 1959.

In the United States District Court for the Western District of Washington, Northern Division

No. 41632

In the Matter of

ALASKA TELEPHONE CORPORATION,

Debtor.

In Proceedings for the Reorganization of a Corporation.

REFEREE'S CERTIFICATE ON REVIEW

To the Honorable William J. Lindberg, United States District Judge:

This Will Certify that the undersigned Van C. Griffin, the Referee to whom the above-entitled cause was referred by General Order of Reference by the District Court of the United States to hear and determine all matters herein not specifically reserved by the Bankruptcy Act to the Judge, and as to those matters, to hear and report thereon.

That pursuant to said Order of Reference, the question for determining the liability for taxes of the United States came duly on for hearing, the United States being represented by its attorney and the Trustee being represented by his attorney. Witnesses were sworn, oral and documentary evidence was introduced, questions were asked by the Referee and answered by the attorneys and arguments were made and the Referee took the matter under advisement, and thereafter the Referee made, signed and filed his Opinion as to the tax claims of the United States of America and Findings of Fact, Conclusions of Law and Order Determining Liabilities of Taxes of the United States was presented, considered, signed and filed, and the United States has presented and filed its Petition for Review, and, in response thereto, the Referee certifies:

1. That the United States did not prepare, serve or file any Summary of the Evidence within the time fixed by law, or at all.

2. All of the issues determined by the Referee are set forth in the Findings of Fact and Order and his reasons therefore are set forth in his written Opinion, all of which are transmitted herewith, and the only issue presented for review is whether or not the Findings of Fact support the Order.

There is transmitted herewith:

1. Petition to Determine Proper Allowance of Claims of United States for Taxes and Objections Thereto.

2. Order Setting Hearing on Trustee's Petition to Determine Proper Allowance on Claims of United States of America for Taxes and Objections Thereto.

3. Affidavit of Donald A. Schmechel made January 26, 1959.

4. The Original Amended Plan and the Original of the Judge's Orders thereon are on file with the Clerk of the United States District Court and for that reason are not transmitted herewith.

5. Opinion of Referee-Special Master as to the Tax Claim of the United States of America.

6. Findings of Fact and Conclusions of Law.

7. Order Determining Liability for Taxes of the United States.

8. Petition for Review.

Dated at Seattle, in said District, April 8, 1959.

/s/ VAN C. GRIFFIN,
Referee in Bankruptcy.

[Endorsed]: Filed April 9, 1959.

[Title of District Court and Cause.]

PETITION TO DETERMINE PROPER ALLOWANCE OF CLAIMS OF UNITED STATES FOR TAXES AND OBJECTIONS THERETO.

To the Honorable Van C. Griffin, Referee in Bankruptcy of said Court:

Richard D. Harris, as Trustee of Alaska Telephone Corporation, the above named debtor, with reference to the claims of the United States of America for taxes, heretofore filed herein, respectfully submits:

I.

Neither the said debtor, nor the Trustee are now justly and truly indebted to the United States of America for the taxes set forth in the claim of the United States of America filed December 14, 1957 and identified as Claim No. 51 in these proceedings, a copy of which claim is attached hereto as Exhibit A and by this reference incorporated herein, for the reason that said taxes were incurred by the Trustee and paid in full by him on or about December 19, 1957 with a check drawn on the Bank of Petersburg, Alaska, in the amount of $895.85.

II.

The claim filed herein on February 4, 1956 under date of January 30, 1956, and identified as number 23, a copy of which is attached hereto as Exhibit B and by this reference incorporated herein, should be allowed in the amount of $176.82, the principal amount of the taxes, and disallowed for anything in excess thereof for the reason that any excess would be for penalties and interest and not recoverable.

III.

The claim filed herein on January 17, 1956 bearing date January 16, 1956, identified herein as claim number 16½, a copy of which is attached hereto labeled Exhibit C and by this reference incorporated herein, should

(A) Be allowed and paid in the amount of $57,000.00, in full payment thereof, for the reason that the Secretary of the Treasury did not file in the office of the Referee-Special Master a proper acceptance or rejection of the proposal to pay said amount within 90 days after receipt of notice to do so, and consent to the acceptance thereof is conclusively presumed under the bankruptcy statutes.

(B) In the alternative, in the event the Court declines to grant (A), the aforesaid claim should be allowed and paid only in the amount of $54,422.13, in full payment thereof, said sum being the correct principal amount of the taxes. The Trustee objects to any amount in excess of said $54,422.13 for the reason that any excess would constitute interest and penalties not recoverable in these proceedings.

Wherefore, Richard D. Harris, said Trustee, prays that an order be entered allowing the aforesaid claims as set forth above, sustaining his objections to any amounts in excess thereof, and for his costs, and such other relief as may be just and equitable.

/s/ RICHARD D. HANIS, (D.A.S.)
Trustee-Objectant.

/s/ DONALD A. SCHMECHEL
Attorney for Trustee-Objectant.

Office & P. O. Address:
1010-1411 Fourth Avenue Building,
Seattle 1, Washington.

EXHIBITS "A," "B" AND "C" ATTACHED

Duly Verified.

[Endorsed]: Filed Jan. 16, 1959.

FORM 2317 (March 1950)

U. S. TREASURY DEPARTMENT—INTERNAL REVENUE SE. .E

PROOF OF CLAIM FOR INTERNAL REVENUE TAXES

AMENDMENT #3 TO PROOF OF CLAIM DATED 1-30-56 10-27-55

IN THE UNITED STATES DISTRICT COURT

FOR THE (STATE) TERRITORY OF ALASKA
JUNEAU, ALASKA

IN THE MATTER OF:

ALASKA TELEPHONE CORP.
JUNEAU, ALASKA

DOCKET NO. .....

TYPE OF PROCEEDING BANKRUPTCY - CHAPT X

CLAIM OF THE UNITED STATES
FOR INTERNAL REVENUE TAXES

The undersigned officer of the Internal Revenue Service, a duly authorized agent of the United States in this behalf, being duly sworn, deposes and says that:

1. ALASKA TELEPHONE CORP. is justly and truly indebted to the United States in the sum of $807.37 with interest thereon as hereinafter stated;

2. The said debt is for taxes due under the internal revenue laws of the United States as follows:

KIND OF TAX AND PERIOD	AMOUNT DUE	REMARKS	DATE TAX LIEN AROSE
Withholding 12-31-55	$807.37		12-13-57

Filed this 14th day of Dec 1957
at 9 a.m. o'clock.
Sam L. Griffin

3. No part of said debt has been paid and the same is now due and payable at the Office of the District Director of Internal Revenue;
4. There are no set-offs or counterclaims to said debt;
5. Except for the statutory tax liens which arose on the dates above stated, the United States does not hold, to the deponent's knowledge or belief, any security or securities for said debt;
6. No note or other negotiable instrument has been received for said debt or any part thereof, nor has any judgment been rendered with respect to said debt; and
7. Said debt has priority and must be paid in full in advance of distribution to creditors as and to the extent provided by law:

IN BANKRUPTCY ACT PROCEEDINGS see Sections 64, 77e, 199, 337(2), 455, and 659 of the Bankruptcy Act (11 U.S.C. 104, 205(e) 599, 737(2), 855, and 1059).

IN OTHER PROCEEDINGS see Section 3466 of the Revised Statutes (31 U.S.C. 191). Also, attention is invited to Section 3467 (31 U.S.C. 192) with respect to the personal liability of any executor, administrator, or other person who fails to pay the claims of the United States in accordance with their priority.

SUBSCRIBED AND SWORN TO BEFORE ME THIS 13 day of December 1957 Rose A. Osage Notary Public	SIGNATURE James L. Milan James L. Milan TITLE Acting Chief, DAR Branch Office of the District Director of Internal Revenue ADDRESS P. O. Box 1583 Tacoma, Washington

U. S. GOVERNMENT PRINTING OFFICE : 1957—O-417486

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IN THE DISTRICT COURT FOR THE Western DISTRICT OF WASHINGTON
Northern DIVISION

In the Matter of

Alaska Telephone Corp) Index or Docket No. 41632
Chapter X
) In Bankruptcy

State of Washington
County of Pierce } ss

CLAIM OF UNITED STATES FOR TAXES

William E Frank, Director of Interna. Revenue for the District of Washington, a duly authorized agent for the United States in this behalf, being duly sworn, deposes and says:

1 That taxpayer (s) above named, is justly and truly indebted to the United States in the sum of $ 301.73, with interest thereon as hereinafter stated.

2 That the nature of the said debt is Internal Revenue taxes due pursuant to law as follows:

Nature of Tax and Statute Involved	Year or Taxable Period Ended	Amount of Tax	With Interest at the rate of 6% per annum until paid. Interest began:	Assmt List Recd
FUTA	1953 Addl	301.73	None Claimed No Lien Filed	1-27-56

Filed this 4th day of February 19 56
9 am o'clock.

Filed this 4th day of February 1956
at 9 am o'clock.
Sam L. Griffin

3 That no part of said debt has been paid, but that the same is now due and payable at the offiee of the Director of Internal Revenue at Tacoma, Washington.

4 That there are no set-offs or counterclaims to said debt.

5 That the United States does not hold, and has not, nor has any person by its order, or to deponent's knowledge or belief, for its use, had or received, any security or securities for said debt, except statutory liens.

6 That the said indebtedness is now due and payable; that no note or other negotiable instrument has been received for said debt or any part thereof; and that no judgment has been rendered thereon.

7 That said debt has priority, and must be paid in full in advance of distribution to creditors, as and to the extent provided in Section 64 or Section 659 of the Bankruptcy Act, Section 3466 of the Revised Statutes, or other applicable provisions of law. Attention is also called to the provisions of Section 3467 of the Revised Statutes, with respect to the personal liability of every executor, administrator, assignee or other person who fails to pay the claims of the United States in accordance with their priority.

Dated this 30 day of January 1956

William E Frank
District Director of Internal Revenue
For the District of Washington
By
E Jarrett
Chief Spec Pro Sec

Subscribed and sworn to before me this 30 day of January 1956

Marcell K. Hay
Notary Public

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This Proof of Claim filed - Chapt X voids Proof of dated 10-27-55 filed under Chapt XI.

IN THE DISTRICT COURT OF THE United States DISTRICT OF WASHINGTON
Northern DIVISION

In the Matter of

Alaska Telephone Corp) Index or Docket No. 41632

) In Bankruptcy Chapter X

State of Washington
County of Pierce } ss

CLAIM OF UNITED STATES FOR TAXES

William E Frank, Director of Internal Revenue for the District of Washington, a duly authorized agent for the United States in this behalf, being duly sworn, deposes and says:

1 That taxpayer (s) above named, is justly and truly indebted to the United States in the sum of $ 65,559.43, with interest thereon as hereinafter stated.

2 That the nature of the said debt is Internal Revenue taxes due pursuant to law as follows:

Nature of Tax and Statute Involved	Year or Taxable Period Ended	Amount of Tax	With Interest at the rate of 6% per annum until paid. Interest began:	Asmt List Recd

SEE STATEMENT ATTACHED

Filed this 17th day of Jan 1956

Filed this 17th day of Jan 1956
at 9 AM o'clock.
Jan L. Griffin
REFERER

3 That no part of said debt has been paid, but that the same is now due and payable at the office of the Director of Internal Revenue at Tacoma, Washington.

4 That there are no set-offs or counterclaims to said debt.

5 That the United States does not hold, and has not, nor has any person by its order, or to deponent's knowledge or belief, for its use, had or received, any security or securities for said debt, except statutory liens.

6 That the said indebtedness is now due and payable; that no note or other negotiable instrument has been received for said debt or any part thereof; and that no judgment has been rendered thereon.

7 That said debt has priority, and must be paid in full in advance of distribution to creditors, as and to the extent provided in Section 64 or Section 659 of the Bankruptcy Act, Section 3466 of the Revised Statutes, or other applicable provisions of law. Attention is also called to the provisions of Section 3467 of the Revised Statutes, with respect to the personal liability of every executor, administrator, assignee or other person who fails to pay the claims of the United States in accordance with their priority.

Dated this 16 day of January 1956

Subscribed and sworn to before me this 16 day of January 1956

Marcil L. Hay
Notary Public

William E Frank
District Director of Internal Revenue
For the District of Washington
By J. R. Leavitt
Chief Spec Pro Sec

TAC-57a

16½

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Receipt of Original of within claim is hereby acknowledged this _____ day of _____ 19___

_____
Name and Title

Receipt of Duplicate original of within claim is hereby acknowledged this _____ day of _____ 19___

_____
Name and Title

Index or Docket No. _____ Year _____

IN THE MATTER OF

_____

CLAIM OF THE UNITED STATES FOR TAXES

District Director of Internal Revenue
District of Washington

United States Attorney
District of Washington

To: _____

State of Washington
County of Pierce } ss

Rose Osage, being duly sworn, deposes and says that

rnal Revenue

S FOR TAXES

Year

State of Washington
County of Pierce } ss

Rose Osage, being duly sworn, deposes and says that she is over the age of 18 years and resides at Tacoma, Washington that on the 16 day of January 19 56, she served an original claim of which the within is a copy, on Alaska Telephone Corp by depositing the claim in the mails in a securely sealed, postpaid wrapper addressed to the Attorney Patterson, Maxwell & Jones 428 White Henry Stuart Bldg Seattle, Wash at his office at

Subscribed and sworn to before me this

16 day of January 19 56 Rose Osage Rose Osage

Marcella Ray Marcella L. Ray
Notary Public

TAC-57

Lien	Tax	Period	Amount	Int at 6% from --		Asmt List Recd
24571	WE	3-31-52	$608.84 Bal	3-6-53 to 11-21-55 =	$129.98	3-5-53
Filed King Co 12-8-53				5% Coll Pen	131.20	
24571	WE	6-30-52	1923.02 Bal	3-6-53 to 11-21-55 =	$418.89	"
Filed King Co 12-8-53				5% Coll Pen		
24571	WE	9-30-52	6613.75	3-6-53 to 11-21-55		"
Filed King Co 12-8-53						
24571	WE	12-31-52	5801.08 Bal	3-6-53 to 11-21-55 =	$936.44	"
Filed King Co 12-8-53						
24963	WE	3-31-53	6265.64	5-13-53 to 11-21-55		5-12-53
Filed King Co 12-8-53						
26099	WE	6-30-53	7755.29	8-19-53 to 11-21-55		8-19-53
Filed King Co 12-8-53						
27465	WE	9-30-53	6051.23	11-6-53 to 11-21-55		11-6-53
Filed King Co 12-8-53						
24571	MT	2/52-12/52	21,406.71	3-6-53 to 11-21-55		3-5-53
Filed King Co 12-8-53						
24949	MT	1/53-3/53	4633.16	4-30-53 to 11-21-55		4-29-53
Filed King Co 12-8-53						
26099	MT	4-53	51.56	7-20-53 to 11-21-55		7-20-53
Filed King Co 12-8-53						
26099	MT	6-53	1064.31	8-18-53 to 11-21-55		8-18-53
Filed King Co 12-8-53						
27775	MT	9-53	3384.14	11-20-53 to 11-21-55		11-20-53
Filed King Co 2-16-54						
		Total	$ 65,559.43			

26099 Filed King Co 12-8-53	MT	6-53	1064.31	8-18-53 to 11-21-55	8-18-53
27775 Filed King Co 2-16-54	MT	9-53	3384.1m	11-30-53 to 11-21-55	11-20-53

Total $ 65,559.43

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[Title of District Court and Cause.]

ORDER SETTING HEARING ON TRUSTEE'S PETITION TO DETERMINE PROPER ALLOWANCE ON CLAIMS OF UNITED STATES OF AMERICA FOR TAXES AND OBJECTIONS THERETO

This matter having come on duly before the undersigned Referee-Special Master in the above proceedings, upon the verified petition of Richard D. Harris, Trustee, petitioning the court to determine the proper allowances on claims of the United States of America for taxes and objections to said claims, now, therefore, it is hereby

Ordered, Adjudged and Decreed:

1. That a hearing will be held before the Honorable Van C. Griffin, Referee-Special Master, in Room 601, U. S. Court House, Seattle, Washington, at 10:00 a.m. on the 26 day of January, 1959, upon the petition of the Trustee to determine the proper allowances to be made on the claims of the United States of America for taxes, and certain objections to said claims, which hearing may be continued from time to time without further notice except the announcement of the continued hearing at said time.

2. The Trustee is directed to have a certified copy of this order and a copy of said petition (a) served upon the United States Attorney for the Western District of Washington at Seattle, Washington, on or before the 16 day of January, 1959, and (b) mailed to the Secretary of The Treasury, Washington, D.C. and the District Director of Internal Revenue, at Tacoma, Washington, on or before the 16 day of January, 1959,

and such notice shall be deemed good and sufficient notice of said hearing.

Dated this 16 day of January, 1959.

/s/ VAN C. GRIFFIN,
Referee-Special Master.

Presented by:

/s/ DONALD A. SCHMECHEL,
Donald A. Schmechel,
Attorney for Richard D. Harris, Trustee.

[Endorsed]: Filed Jan. 16, 1959.

[Title of District Court and Cause.]

AFFIDAVIT OF MAILING

State of Washington, County of King—ss.

Donald A. Schmechel makes solemn oath that he is over the age of twenty-one (21) years and is not a party to this proceeding.

That on the 30th day of September, 1958, he air mailed a certified copy of the attached Plan of Reorganization, a copy of the attached Notice, and the original of the attached receipt to the Secretary of the Treasury, Washington 25, D.C., by depositing the same in the post office, addressed to said party at the address indicated above, airmail postage prepaid.

/s/ DONALD A. SCHMECHEL.

Subscribed and sworn to before me this 26th day of January, 1959.

HELEN BENCH,
[Seal] Notary Public in and for the State of Washington, residing at Seattle.

[Title of District Court and Cause.]

ORDER PRESCRIBING FORM OF NOTICE TO SECRETARY OF TREASURY TO ACCEPT OR REJECT PLAN.

Upon the annexed petition of Richard D. Harris, Trustee of the Alaska Telephone Corporation, the above named debtor, verified the 22nd day of September, 1958, praying that the notice to the Secretary of the Treasury to accept or reject the plan for the reorganization of said debtor, approved by this Court under Section 174 of the Act of Congress relating to Bankruptcy on the 28th day of August, 1958, shall be in the form and manner proposed in the said petition, and it appearing that no notice of a hearing thereon should be given, and good cause appearing to me therefor, it is

Ordered that Richard D. Harris, said Trustee, within ten (10) days after the entry of this order, be, and he hereby is, directed to serve upon the Secretary of the Treasury, Washington, District of Columbia, personally or by mail, the following written notice:

In the United States District Court for the Western District of Washington, Northern Division

No. 41632

In the Matter of

ALASKA TELEPHONE CORPORATION,

Debtor.

In Proceedings for the Reorganizations of a Corporation.

To the Secretary of the Treasury, Washington, District of Columbia:

Notice is Hereby Given that with respect to the unsecured claim of the United States of America for taxes in the amount of $65,559.43 against the above

named debtor, you are required, not more than ninety (90) days after the receipt of this notice, to file in this Court your acceptance or rejection of the plan for the reorganization of said debtor, approved by this Court under Section 174 of the Act of Congress relating to Bankruptcy, on the 28th day of August, 1958, a certified copy of which plan accompanies this notice, and under which plan the United States of America is to receive the sum of $57,000.00 in cash, after consummation of said plan, in full settlement thereof; and upon your failure so to do, your consent to the said plan shall be conclusively presumed.

By Order of the Court.

Dated this 22nd day of September, 1958.

/s/ RICHARD D. HARRIS,
Trustee.

which notice shall be accompanied by a certified copy of the said plan; and it is further

Ordered that the said Trustee file proof of receipt by the Secretary of the Treasury of said notice accompanied by a certified copy of said plan and of the date of such receipt.

Dated this 22nd day of September, 1958.

/s/ WILLIAM J. LINDBERG,
District Judge.

Presented by
/s/ DONALD A. SCHMECHEL
of Wright, Innis, Simon & Todd
Attorneys for
Richard D. Harris,
Trustee.

[Title of District Court and Cause.]

RECEIPT

Receipt is hereby acknowledged of the following documents:

1. Certified copy of Amended Final Plan of Reorganization.

2. Conformed copy of Petition for Form of Notice to Secretary of Treasury to Accept or Reject Plan.

3. Conformed copy of Order Prescribing Form of Notice to Secretary of Treasury to Accept or Reject Plan.

Dated this ..... day of October, 1958.

Secretary of the Treasury

By: _____

[Title of District Court and Cause.]

AMENDED FINAL PLAN OF REORGANIZATION OF ALASKA TELEPHONE CORPORATION, DEBTOR, A PUBLIC UTILITY

August 28, 1958

Classes of Creditors and Stockholders of the Debtor:

1. The United States of America with respect to all claims for taxes against said debtor.

2. The United States of America with respect to claims against said debtor other than claims for taxes.

3. Any state, territory, or political subdivisions thereof, with respect to claims for taxes against said debtor.

4. To be treated equally as one class:

(a) Holders of all unsecured general claims against the debtor.

(b) Holders of all debentures issued by the debtor corporation, including Series A, Series B, Series C, and Series D, and all other creditors holding claims against the debtor.

Article I.

Who Makes Offer

This offer is being made by and on behalf of the following persons, who propose to purchase, and assume management and financing. of the debtor corporation, and are hereinafter called proponents:

Blanchett, Hinton & Jones, Inc., Seattle securities and investment firm.

C. Spencer Clark, Chairman of the Board, Cascade Natural Gas Company and Executive Vice-President, Northern Ontario Natural Gas Company.

E. B. Clark, Seattle investor.

Irving Clark, Jr., Seattle Lawyer and real estate broker.

Darrah Corbet, President, Smith Cannery Machines Company, and Director, National Bank of Commerce of Seattle.

Article II.

Provisions Altering or Modifying the Rights of Creditors

A. All claims included in Classes 1, 2, and 3 are to be paid in cash in full by the Trustee, in such amounts as may be finally allowed by the Court, without any interest thereon, except as to the following two claims, which may be paid in installments in the amount and manner determined by the Court:

(1) Claim of the United States of America; Claim No. 16½ for $65,558.48.

(2) Claim of the United States of America; Claim No. 50 for $7,054.67.

B. Creditors in Class 4(a) and Class 4(b): Holders of general claims and holders of old debentures, upon the confirmation of the plan, shall be entitled to receive from the Trustee the balance of the funds paid in by proponents under this plan, pro rata according to the dollar value of their claims, which shall then be extinguished by the Trustee.

Article III.

Provisions for the Payment of Administration Expenses and Other Allowances

All costs, obligations and expenses of administration and other allowances which may be made by the Judge in this proceeding under Chapter XI of the Bankruptcy Act and Under Chapter X of the Bankruptcy Act, shall be paid in cash by the trustee, as the Judge shall direct.

Article IV.

Provisions for Classes of Creditors Which Are Affected by and Do Not Accept the Plan by the Requisite Majority

In respect of any Class of Creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under Chapter X of the Act of Congress relating to bankruptcy, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims shall be provided in the order confirming the plan by any one or more of the methods prescribed by Section 716(7) of the said Act.

Article V.

Property Dealt with by the Plan

The offer made herewith is to acquire Alaska Telephone Corporation, including stock equites and all other property, tangible or intangible, for $230,000.00, payable on or before confirmation of this plan, $25,000.00 of which has heretofore been paid to the Trustee. The Trustee will issue new stock to proponents in consideration of this payment. All properties of the debtor will pass to proponents free and clear of all liens, except as specified in Article VI.

Article VI.

Obligations to Be Assumed

Proponents agree that their acquisition of the debtor corporation will carry with it the following obligations, and only the following obligations, which will then cease to be the obligations of the Trustee:

A. The contract balance remaining to be paid to Automatic Electric Sales Corporation for the Seward central office equipment, which balance is believed to be in the amount of $41,500.00.

B. The duties of the corporation under the contract made by the Trustee for the construction of a central office building in Seward, the total obligation on which is believed to be in the approximate amount of $30,000.00.

C. Any liability of the corporation by reason of customer deposits as of the day assets and operations are actually taken over by proponents, which cash deposits will pass under Article V hereof.

Proponents specifically disclaim and decline to assume any other obligations whatever of the corporation.

Article VII.

Future Plans of Proponents

Proponents hereby specifically agree that they are taking over the debtor for the purpose of continuing to carry on the telephone business in the four municipalities involved for a period of three years, or until such time as an Alaska public service commission, or some such regulatory agency, by whatever name it may be called, assumes jurisdiction of the regulations of the telephone business in Alaska, whichever shall occur first.

Article VIII.

Provisions for the Retention, Enforcement, Settlement, or Adjustment of Claims Belonging to the Debtor or to the Estate

All causes of action which the debtor or its Trustee may have against any persons shall be retained by the Trustee and enforced by him for the benefit of the holders of claims classified as Class 4 against the debtor.

Respectfully submitted,

BLANCHETT, HINTON & JONES, Inc.
C. SPENCER CLARK
E. B. CLARK
IRVING CLARK, JR.
DARRAH CORBET
(Sgn) IRVING CLARK, JR.

By: IRVING CLARK, JR., their attorney
1090 Dexter Horton Building
Seattle 4, Washington
Phone: MUtual 2-0080

[Title of District Court and Cause.]

PETITION FOR FORM OF NOTICE TO SECRETARY OF TREASURY TO ACCEPT OR REJECT PLAN

To the Honorable William J. Lindberg, Judge of the District Court of the United States for the Western District of Washington, Northern Division:

The petition of Richard D Harris respectfully represents:

I.

On the 30th day of September, 1955, a petition was filed herein by Alaska Telephone Corporation, the above named debtor, praying that proceedings be had under Chapter XI of the Act of Congress relating to Bankruptcy, and thereafter on the 21st day of November, 1955, an order was entered herein approving the amendment of said petition to bring the proceedings under Chapter X of the Bankruptcy Act and approving such amendment and appointing your Petitioner as Trustee of said debtor under said Chapter X. Your Petitioner has duly qualified and is now acting as such Trustee.

II.

Your Petitioner prepared, and on the 9th day of May, 1958, filed a plan for the reorganization of said debtor pursuant to Section 169 of the said Act, and thereafter other plan for the reorganization of said debtor were prepared and filed, and in an order entered by the above entitled Court on August 28, 1958, the plan known as the Clark Plan was approved by this Court under Section 174 of the said Act, and the Court has fixed October 13, 1958, as the time within which creditors affected thereby may accept the same.

III.

The United States of America is an unsecured creditor of the said debtor and asserts a claim for taxes, including interest and penalties, in the amount of $65,-559.43, as evidenced by the claim identified as Claim No. 16½ in these proceedings and filed on January 17, 1958.

IV.

The aforesaid Clark Plan for the debtor's reorganization does not provide for the payment of the said claim of the United States in full, but does provide for the payment of $57,000.00 in full settlement thereof. Prior to the institution of these proceedings on September 30, 1955, the debtor entered into an offering in compromise under date of June 11, 1954, which contemplated the settlement of all of the taxes, including penalties and interest, involved in the aforesaid Claim No. 16½, for the total sum of $57,000.00 payable in installments. Prior to September 30, 1955, the debtor had deposited a total of $40,000.00 with the United States of America pursuant to the aforesaid offer in compromise, and thereafter, pursuant to a hearing in these proceedings with notice to the United States of America, an order was entered by the Court on the 27th day of November, 1957, directing the United States of America to return the aforesaid $40,000.00 to Petitioner, and said $40,000.00 has since been returned. That under the aforesaid Clark Plan, the $57,-000.00 to be paid to the United States of America in full settlement of the aforesaid claim will be paid after consummation of the plan, when authorized by the Court.

V.

Service by mail or in person upon the Secretary of the Treasury, at Washington, District of Columbia, of the following written notice to accept or reject the said plan is adequate notice thereof.

In the United States District Court for the Western District of Washington, Northern Division

No. 41632

In the Matter of

ALASKA TELEPHONE CORPORATION,

Debtor.

In Proceedings for the Reorganization of a corporation.

To the Secretary of the Treasury, Washington, District of Columbia:

Notice Is Hereby Given that with respect to the unsecured claim of the United States of America for taxes in the amount of $65,559.43 against the above named debtor, you are required, not more than ninety (90) days after the receipt of this notice, to file in this Court your acceptance or rejection of the plan for the reorganization of said debtor, approved by this Court under Section 174 of the Act of Congress relating to Bankruptcy, on the 28th day of August, 1958, a certified copy of which plan accompanies this notice, and under which plan the United States of America is to receive the sum of $57,000.00 in cash, after consummation of said plan, in full settlement thereof; and upon your failure so to do, your consent to the said plan shall be conclusively presumed.

By Order of the Court.

Dated this 22nd day of September, 1958.

/s/ RICHARD D. HARRIS,
Trustee

Wherefore your Petitioner prays that this Court prescribe that the notice to the Secretary of the Treasury

to accept or reject the said plan shall be in the form and manner as aforesaid, and that your Petitioner have such other and further relief as is just.

/s/ RICHARD D. HARRIS,
Trustee

State of Washington, County of King—ss.

I, Richard D. Harris, the Petitioner named in the foregoing petition, do hereby make solemn oath that the statements contained therein are true according to the best of my knowledge, information, and belief.

/s/ RICHARD D. HARRIS,
Trustee.

Subscribed and sworn to before me this 22nd day of September, 1958.

/s/ C. M. DWYER
[Seal] Notary Public in and for the State of Washington, residing at Seattle.

[Endorsed]: Filed Jan. 27, 1959.

[Title of District Court and Cause.]

OPINION OF REFEREE-SPECIAL MASTER AS TO THE TAX CLAIM OF THE UNITED STATES OF AMERICA.

From the evidence introduced and from failure of parties to introduce evidence which was within their knowledge or possession and from the records and files herein, the Referee-Special Master Finds, Concludes and Decides:—

That on or about the 21st day of November, 1955, the Honorable William J. Lindberg, Judge of the United

States District Court before whom this matter was and is pending, entered an Order Approving the filing of the Debtor's Petition under Chapter X and a part of that Order referred all matters herein to Van C. Griffin, as Referee-Special Master, to hear and determine, except such matters as are specifically reserved to the Judge by the terms of the Bankruptcy Act and said Order has never been modified and the question of the tax of the United States is not specifically reserved to the Judge and at all times has been and now is before the Referee-Special Master for determination.

A copy of said Order and a copy of the Notice and proposed Plan was duly served upon the Secretary of the Treasury and he did not, as hereinafter mentioned, accept or reject said Plan for a period of more than ninety (90) days, and he is therefore conclusively presumed to have accepted the Plan.

The Secretary of the Treasury took no action in respect to the Notice and Order served upon him under the terms of Section 199 of the Bankruptcy Act, except there was, on December 26, 1958, filed with the Clerk of the United States District Court a paper denominated "Notice of Rejection of the Trustee's Plan", but, after due examination and consideration, the Referee Special Master Finds, Concludes and Decides that said Notice was wholly ineffectual to express the rejection thereof for the following reasons.

1. It was not signed by the Secretary of the Treasury.

2. The purported signature is not legible, is not the signature of the Secretary of the Treasury and on the face of said Notice and nowhere else in the record is there any showing as to the incapacity of the Secre-

tary of the Treasury for any reason or why anyone should act for him or any showing that he authorized anyone to act for him and not even affirmation or acknowledgement by the person so acting as to what, if any, authority he had to act and what, if any, official capacity he enjoyed. this Referee being unable to find anything in the statute creating the office of Acting Secretary of the Treasury.

3. Rule XI of the Rules of Civil Procedure provides that every pleading of a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose address shall be stated. A party who is not represented by an attorney shall sign his pleading and state his address.

Rule 16 of the Local Rules of the United States District Court for the Western District of Washington provides that names shall be typed or printed under all signatures to pleadings.

The purported Rejection did not comply with these rules and, being illegible, the violation is material.

The provisions of the Plan of Corporate Reorganization are therefore conclusively presumed to be accepted by the Secretary of the Treasury and the Trustee therefore will pay to the Secretary of the Treasury the sum of $57,000.00 and that sum may be paid independently of any Review or appeal from Orders pertaining to the United States tax claim and may be accepted by the United States without prejudice to its right to claim a greater sum, but when said sum is tendered to the United States is no event is interest thereafter to be charged or allowed.

The Referee-Special Master is confident that the foregoing decision is sound but, in order to avoid the possible necessity of a second review or appeal, wishes

to go forward and decide the issues tendered and tried by the parties and that is as to what amount would now be due the United States if the Secretary of the Treasury had, in law and in fact, rejected the amount set forth in the Plan of Corporate Reorganization. The Director of Internal Revenue offered certified copies of the assessment as tending to prove the amount of the tax. The Debtor, prior to these proceedings, made an offer in compromise and paid thereon the sum of $40,000.00, which sum was retained by the United States until an Order was entered in these proceedings directing that he return the money to the Trustee herein.

A certain part of the tax included in the United States claim has been paid and a certain part of the tax was not chargeable to the Debtor, but was chargeable to and paid by the Trustee herein, and it also appears that in making the assessment the Director, in some instances, compounded the interest and when that situation is developed, it is the duty of the Court to receive evidence outside of the assessment and determine the amount of tax. In fact, there is little or no dispute as to the principle amount of the tax except that the Trustee contends that the excise tax was reported upon an accrual basis, based upon the billing for telephone service whereas it developed that a substantial portion of these bills were never paid and it would therefore be unjust to charge the tax on the payment of a debt that was never collected. However, the Trustee was not prepared to prove with certainty the exact amount of credit that should be given so the Referee-Special Master is going to adopt the principal tax as established by the assessment records of the Director, which seems to indicate, in view of all the evidence, is the sum of $56,382.93 of unpaid principal tax.

The conflict of authorities as to whether or not penalties included in tax liens may be paid by the Trustee out of the funds in the estate and the payment by the Trustee of post-bankruptcy interest is, upon closer examination, more apparent than real. For instance, the case of Knox-Powell Stockton Company, reported in 33 American Bankruptcy Reports, page 766, 100 Federal 2nd, 979, was one in which the adjudication occurred in May of 1933 and was long before the passage of the Chandler Act and other amendments relating to the issues here. Some of the cases referred to arose out of a debt secured by a mortgage, but those are distinguishable because in those cases there was a voluntary advancement of funds secured by an orthodox mortgage and the funds enriched the estate, whereas the tax is an obligation imposed and in a sense does not contribute to the assets of the estate to the same extent as does money loaned on a mortgage.

In the case of

In the Matter of G. N. Childress, etc. in the U. S. District Court for the middle District of North Carolina, decided by the Referee about April, 1958, and reported in full in the Journal of the National Association of Referees in Bankruptcy for January, 1959, at page 12, the authorities are collected and the reasons given which this Court adopts as its own, and this Court is reliably advised that the referee's decision was affirmed upon review by the District Court, altho that may now be on appeal to the Circuit Court.

Findings of Fact and Order in conformity with this Opinion may be presented to the Court at 10 o'clock A.M. on Friday, January 30th, 1959.

Dated at Seattle, in said District, January 27, 1959.

/s/ VAN C. GRIFFIN,
Referee-Special Master.

[Endorsed]: Filed Jan. 27, 1959.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Trustee's Petition to determine proper allowances of claims to the United States for taxes and Objections thereto came duly on for hearing, the Trustee appearing in person and by his attorney, Donald A. Schmechel, and the United States appearing by Thomas R. Winter, Special Assistant to the Regional Counsel for the Internal Revenue Service, and Jacob A. Mikkelborg, Assistant United States District Attorney, and oral and documentary evidence was introduced, the matter was argued to the Court and the Court made and entered its Memorandum Decision herein and now makes the following

Findings of Fact

I.

That heretofore and on or about September 22, 1958, and on due proceedings had, Judge William J. Lindberg made and entered an Order Prescribing Form of Notice to the Secretary of the Treasury to accept or reject Plan, which notice provided that under the Plan herein the United States of America was to receive the sum of $57,000.00 in cash in full settlement of its tax claim and that, upon its failure to reject said Plan, the consent to said Plan shall be conclusively presumed, and said Notice was duly served upon the Secretary of the Treasury of the United States.

II.

On or about the 21st day of November, 1955, by a General Order of Reference, Judge William J. Lindberg referred all matters in these proceedings to Van

C. Griffin, Referee-Special Master, except such matters as are by law reserved to the Judge, and this question of acceptance or rejection is not specifically reserved to the Judge and is therefore before the Referee-Special Master and no acceptance or rejection of any kind was served or filed with the Referee-Special Master or with his clerk, or at all, and the matter did not come to his attention until long after the ninety (90) days, referred to in said Notice, had expired, to-wit: on January 12, 1959.

III.

On December 26, 1958, there was filed in the office of the Clerk of the United States District Court for the Western District of Washington a document denominated "Notice of Rejection of Trustee's Plan," but said document had no force and effect because (a), it was not signed by the Secretary of the Treasury, (b), the purported signature is over a notation of "Acting Secretary of the Treasury," but the signature itself is illegible, (c) Rule XI of the Rules of Civil Procedure provides that every pleading of a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose address shall be stated. A party who is not represented by an attorney shall sign his pleading and state his address; Rule 16 of the Local Rules of the United States District Court for the Western District of Washington provides that names shall be typed or printed under all signatures to pleadings.

IV.

The Director of Internal Revenue duly assessed taxes in the principal sum of $56,382.93, interest in the sum of $1,056.28 and penalties in the sum of $7,714.72, and

between the dates of December 8, 1953, and February 16, 1954, filed notice of claim of lien with the Auditor of King County, Washington, and demanded payment at about said dates, and no payments were made, except as hereinafter stated.

V.

On February 4, 1959, the Trustee herein paid to the United States the sum of $57,000.00 to conform with the Plan of Corporate Reorganization and said sum has been kept and retained by the said United States, but if it be relieved from the acceptance of said sum as in confirmation of said Plan, nevertheless the money would be applied upon the payment of the principal of the tax, so that, in any event, the principal of the tax is fully paid.

VI.

The Debtor made to the United States an offer in compromise and deposited with the United States, to be applied upon its taxes, the following amounts upon the following dates:

$36,000.00	—	June 7, 1954
1,000.00	—	February 8, 1955
1,000.00	—	March 14, 1955
1,000.00	—	April 13, 1955
1,000.00	—	August 19, 1955

and said money was kept and retained by the United States until the 17th day of January, 1958, when it was returned to the Trustee herein. The interest on the amount so deposited for the time withheld at 6% per annum is the sum of $3,863.81.

VII.

If it be finally determined that the amount certified by the United States District Judge of $57,000.00 was, in fact, fair and equitable and that it discharges all the taxes, interest and penalties, then there would be no necessity of computing the amount of anti-bankruptcy interest and post-bankruptcy interest, but, since that matter is still in dispute, no one has computed the exact amount of interest that would be owing up to September 30, 1955, the date of bankruptcy, but leaving that matter aside, the only portion of the claim of the United States that can be said to be in dispute and unpaid is its claim for:

1. Penalties.
2. Compound interest.
3. Post-Bankruptcy interest.

Dated at Seattle, in said District, February 9th, 1959.

/s/ VAN C. GRIFFIN,
Referee-Special Master.

From the foregoing Findings of Fact, the Referee-Special Master makes the following

Conclusions of Law

1. That the provisions of the Plan of Corporate Reorganization, which stated that the sum of $57,000.00 was a reasonable and just sum to be paid to the United States in discharge of its tax claim, have been fully complied with and said sum has been paid and the United States of America has no further claim against the Trustee, the funds in his hands or the Debtor corporation.

2. The claim of the United States for penalties is fully answered by Section 57(j), which prohibits the payment of penalties from bankruptcy estates, and there is no exception therein that penalties must be paid if a lien is claimed, and I can think of no reason why the ex-parte filing of a notice would change the basic rights of the parties.

3. My interpretation of the claim of the United States is that certain taxes became due at a date fixed before assessment and that it computes the interest on these taxes between that date and the date of assessment and includes the interest so computed in the assessment and that such computation results in charging interest on interest, or, compound interest.

"Compound interest or interest on interest is not favored in the law." 47 C. J., page 15

The following excerpts are from the case of Vanston Bondholders, etc. v. Green, 329 U. S. 156, 91 Law Edition, 163

"We agree with the conclusion of the Circuit Court of Appeals that the claim for interest on interest should not be permitted to share in the debtor's assets, but disagree with the reasons given for that conclusion." * * *

"For assuming, arguendo, that the obligation for interest on interest is valid under the law of New York, Kentucky, and the other states having some interest in the indenture transaction, we would still have to decide whether allowance of the claim would be compatible with the policy of the Bankruptcy Act." * * *

"But bankruptcy courts must administer and enforce the Bankruptcy Act as interpreted by this Court in accordance with authority granted by Congress to determine how and what claims shall be allowed under equi-

table principles. And we think an allowance of interest under the circumstances shown by this case would not be in accord with the equitable principles governing bankruptcy distributions."

"When and under what circumstances federal courts will allow interest on claims against debtors' estates being administered by them has long been decided by federal law. The general rule in bankruptcy and in equity receivership has been that interest on the debtors' obligations ceases to accrue at the beginning of proceedings. Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interests involved. Thus this Court has said: "We cannot agree that a penalty in the name of interest should be inflicted upon the owners of the mortgage lien for resisting claims which we have disallowed. As a general rule, after property of an insolvent passes into the hands of a receiver or of an assignee in insolvency, interest is not allowed on the claims against the funds. The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate."

A judgment entered by a court of competent jurisdiction has a greater presumption of validity than has any ex-parte act of the Director of Internal Revenue and the Bankruptcy Court, being a court of equity and where equitable principles demand, may go behind the face of a judgment or an assessment.

See Pepper v. Linton, 308 U. S. 295, 84 Law Edition, 281.

4. It would be unconscionable and inequitable to allow the United States to charge the assets in the hands of the Trustee with interest on money for the time that said money was in the possession of the United States and during which time the Debtor and the Trustee were deprived of said money and the amount of the interest at 6% per annum on the sums held by the United States for the time so held amounts to $3,510.40 and therefore that sum should be deducted from any claim for taxes or interest which might ultimately be allowed to the United States.

The Referee-Special Master's conclusion that penalties and post-bankruptcy interest should not be paid from the assests of the estate is well supported by reasoning and authority in the case of G. N. Childress, etc. in the United States District Court for the Middle District of North Carolina, cited in the opinion of the Referee-Special Master herein.

As recently as January 8, 1959, in the case of In Re Magnus Harmonica, the United States Court of Appeals, Third Circuit, (Commerce Clearing House 59404) followed the principles announced in Vanston v. Green, 329 U. S., 156, which this Referee-Special Master undertakes to apply here, and in that case the Court said:

"II. Post-petition Interest

We deal here only with interest following the institution of the reorganization proceedings. We are cited to the rule that interest is not recoverable after such a proceeding has begun and to the exception that the rule does not apply when the creditor is secured above the amount of his principal debt.

As to the "interest on interest" claim, that part of it may be disposed of by saying that this is not interest provided for in the contract but is based upon Credit's own idea of handling the charges it made against its borrower. There is no contractual claim to it and the bankruptcy court judge was correct in denying it.

With regard to that part of the interest claim which is within the terms of the contract, we have a closer question. A bankruptcy court is one with equity powers and has a measure of discretion in their exercise. Vanston v. Green, 329 U. S. 156 (1946). In this particular case equitable considerations do not favor giving the claimed payment to this secured creditor. It made overcharges against the debtor outside the terms of the contract and it is only because the debtor is precluded from complaining that the trustee is bound by the debtor's inaction. Such equities as are apparent favor the trustee acting for the general creditors as against Credit. Both the referee and the district judge made an accurate application of equitable principles. Furthermore, this case is like Vanston v. Green, supra, in that the collection of the amount due Credit was deferred by the advent of reorganization and bankruptcy proceedings. This case then fits Vanston v. Green both on its facts and on its statement of equitable principles.

The judgment of the district court will be affirmed."

Dated at Seattle, in said District, February 9, 1959.

/s/ VAN C. GRIFFIN
Referee-Special Master.

[Endorsed]: Filed Feb. 9, 1959.

[Title of District Court and Cause.]

ORDER DETERMINING LIABILITY FOR TAXES OF THE UNITED STATES

The Trustee's Petition to determine proper allowances of claims to the United States for taxes and Objections thereto came duly on for hearing, the Trustee appearing in person and by his attorney, Donald A. Schmechel, and the United States appearing by Thomas R. Winter, Special Assistant to the Regional Counsel for the Internal Revenue Service, and Jacob A. Mikkelborg, Assistant United States District Attorney, and oral and documentary evidence was introduced, the matter was argued to the Court and the Court made and entered its Memorandum Decision herein, and now makes the following

Order

I.

On due proceedings had, the Plan of Corporate Reorganization herein provided for the payment to the United States of $57,000.00 in full for its tax claim, which was duly certified to the Secretary of the Treasury and he did not reject said Plan within ninety (90) days, as provided by law, and therefore he is conclusively presumed to have accepted it and said sum has been duly paid to the United States of America and the Trustee and the assets of the estate and the Debtor are fully discharged from any and all claims of the United States for taxes, penalties and interest.

Done in Open Court this 9th day of February, 1959.

/s/ VAN C. GRIFFIN,
Referee-Special Master.

[Endorsed]: Filed Feb. 9, 1959.

[Title of District Court and Cause.]

PETITION FOR REVIEW

To: Honorable Van C. Griffin, Referee-Special Master

The petition of the United States of America respectfully represents:

I.

Your petitioner, United States of America, is now and at all times herein mentioned was a sovereign and corporate body politic. The debtor is justly and truly indebted to the United States for taxes due under the Internal Revenue laws of the United States, as set forth in the verified claims of the United States filed on its behalf.

II.

On February 9, 1959, your Honor, as Referee-Special Master, entered an order herein, determining the liability for taxes of the United States, providing as follows:

"On due proceedings had, the Plan of Corporate Reorganization herein provided for the payment to the United States of $57,000.00 in full for its tax claim, which was duly certified by the Secretary of the Treasury and he did not reject said Plan within ninety (90) days, as provided by law, and therefore he is conclusively presumed to have accepted it and said sum has been duly paid to the United States of America and the Trustee and the assets of the estate and the Debtor are fully discharged from any and all claims of the United States for taxes, penalties and interest."

The said order was based on Findings of Fact and Conclusions of Law, finding and holding in substance:

1. That the Secretary of the Treasury did not properly file a notice of rejection of the plan of reorgan-

ization, as amended, with respect to the claims of the United States for taxes, as provided in Section 199 of the Bankruptcy Act;

2. That interest on the amounts deposited with the United States under an offer in compromise made prior to the reorganization proceedings by the debtor should be credited against the Government's claim for taxes;

3. That the United States is not entitled to post-bankruptcy proceeding interest on its tax claims which were liens on the debtor's property prior to said insolvency proceedings;

4. That the United States is not entitled to post-bankruptcy proceeding penalties on its tax claims which were liens on the debtor's property prior to the insolvency proceedings;

5. That the United States is not entitled to interest on the total assessments ten days after issuance of notice and demand, to and including September 30, 1955, the date the petition in the proceedings was filed.

III.

The United States of America respectfully assigns the following specifications of error in said Findings of Fact entered February 9, 1959, by the Honorable Referee-Special Master:

1. That the Referee erroneously determined that the evidence adduced by the hearing before said Referee was sufficient to support his finding that the order of the United States District Court of August 28, 1958, requiring notice of rejection or acceptance of the Trustee's proposed plan, as amended, was duly served upon the Secretary of the Treasury, or was sufficient to deter-

mine the date of said service effective to commence running of the 90-day period within which acceptance or rejection according to the terms of the said order must be filed; (Referee's Finding of Fact I)

2. That the Referee erroneously determined that the acceptance or rejection of the Trustee's plan of reorganization, as amended, was improperly filed with the Clerk of the United States District Court, Western District of Washington, and erroneously concluded that the notice of rejection should have been filed with the Referee-Special master, rather than with the Clerk of said United States District Court; (Referee's Finding of Fact II)

3. That the Referee erroneously determined that the notice of rejection was improper and of no effect by virtue of the fact that it was signed by the Acting Secretary of the Treasury without any showing or affirmation of his authority or capacity to so act, and without printing his name below his signature subscribed thereon, and that said irregularities, if any, were material matters of substance; (Referee's Finding of Fact III)

4. That the Referee erroneously determined that the notice of rejection was not effectively filed on December 26, 1958, within the 90 days specified by the order of the United States District Court Judge entered November 5, 1958, and Section 199 of the Bankruptcy Act, as amended; (Referee's Finding of Fact II)

5. That the Referee erroneously determined that the notice of rejection was improper and of no effect by virtue of the fact that the notice of rejection by the Acting Secretary of the Treasury did not bear the name of an attorney for said Acting Secretary and his post

office address, or the address of the Acting Secretary of the Treasury; (Referee's Finding of Fact III)

6. That the Referee erroneously determined that the said notice of rejection by the Acting Secretary of the Treasury failed to comply with Section 199 of the Bankruptcy Act, as amended; (Referee's Findings of Fact II and III)

7. That the Referee erroneously determined that the Trustee of the debtor corporation is entitled to credit on the basis of interest on the sum deposited by the debtor corporation, prior ot the Trustee's appointment, to secure an offer in compromise made by said corporation prior to institution of the bankruptcy proceedings in this cause, and that said Referee erroneously determined that interest accrued at six per cent in the sum of $3,863.81, or at any rate and amount; (Referee's Finding of Fact VI)

8. That the Referee erroneously determined that the conditional tender of the sum of $57,000.00 discharged all liability for taxes, interest, and penalties, thereby making unnecessary the determination of the correct tax liability, including penalties and interest on the assessments (designated by the Referee as compound interest), and post-bankruptcy proceeding interest on the said assessments until paid in full. (Referee's Finding of Fact VII)

IV.

The United States of America respectfully assigns the following specifications of error in said Conclusions of Law entered by the Honorable Referee-Special Master, together with Findings of Fact on February 9, 1959:

1. That the Referee erroneously concluded that the claim of the United States of America has been paid

by virtue of tender of the sum of $57,000.00, and that the United States of America has no further claim against the Trustee, the funds in his hands, or the debtor corporation; (Referee's Conclusion of Law 1.)

2. That the Referee erroneously concluded that Section 57(j) of the Bankruptcy Act, as amended, prohibits payment and collection of penalties from bankrupt estates after institution of bankruptcy proceedings where the tax claims, including penalties, are secured by liens perfected prior to filing of the petition under Chapter X proceedings, as in this cause; (Referee's Conclusion of Law 2.)

3. That the Referee erroneously concluded that interest is not allowable on the assessments duly made pursuant to the Internal Revenue laws of the United States, and erroneously concluded that authorities cited by said Referee are controlling of the issue as to interest in this cause; (Referee's Conclusion of Law 3.)

4. That the Referee erroneously concluded that the claim of the United States is diminished by reason of the deposit of a sum under an offer in compromise and interest on such sum deposited to secure said offer in compromise at any rate or amount based on such deposit; (Referee's Conclusion of Law 4.)

5. That the Referee erroneously concluded that interest accrued subsequent to commencement of insolvency proceedings should not be paid from the assets of the estate where the interest is based on assessments supported by liens perfected prior to commencement of said proceedings, as provided by Section 57(j) of the Bankruptcy Act or other provisions thereof. (Referee's Conclusion of Law 4.)

V.

The Referee-Special Master's Order Determining Liability for Taxes of the United States is erroneous in that:

1. It purports to order that the plan of reorganization was approved and accepted by the United States of America upon the purported failure of the Secretary of the Treasury to reject said plan within 90 days, as provided by law, and further purporting to order that the claims for taxes, penalities and interest have been paid by the subsequent tender of a certified check in the sum of $57,000.00;

2. It fails to allow the claims of the United States in the total sum of $65,336.79 plus interest thereon at the rate of six per cent per annum from the dates of notice and demands, as provided by law, and until paid, except as to the sum of $182.86, which tax liability was not assessed until February 8, 1956, and notice and demand not made until after insolvency proceedings, or until January 27, 1956;

3. It fails to find and conclude that Julian A. Baird, as Acting Secretary of the Treasury, did properly certify by virtue of and pursuant to the provisons of Section 199 of the Bankruptcy Act that he rejected said plan of reorganization, as amended, with respect to the claims of the United States for taxes within the time properly allowed by law, and that the said plan, as amended, providing for the full payment to the United States of its taxes in the sum of $57,000.00 is rejected and not binding upon the United States of America;

4. It fails to allow and order paid post-bankruptcy interest on the tax claims and prior liens of the United States of America;

5. It fails to allow and order paid penalties assessed which were liens on the debtor's property prior to the bankruptcy proceedings, as provided by law;

6. It fails to enter the findings, conclusions and order as requested by the United States of America, claimant.

Wherefore, your petitioner prays that the Referee-Special Master certify to the Judge of this Court and transmit to the Clerk the record in said proceedings, as provided in the Bankruptcy Act, as amended.

United States of America

/s/ CHARLES P. MORIARTY,
United States Attorney

/s/ JACOB A. MIKKELBORG,
Assistant United States Attorney,

/s/ THOMAS R. WINTER,
Special Assistant to the Regional Counsel Internal Revenue Service.

Office and Post Office Address:
1012 U. S. Court House
Seattle 4, Washington.

[Endorsed]: Filed Feb. 18, 1959.

[Title of District Court and Cause.]

NOTICE OF FILING OF REFEREE'S CERTIFICATE ON REVIEW

To: Donald A. Schmechel, Attorney for the Trustee
Thomas R. Winter, Special Assistant to the Regional Counsel Internal Revenue Service.

Notice Is Hereby Given, that the undersigned Referee in Bankruptcy has, on this day filed with the Clerk of the U. S. District Court his Certificate on Review in the above-entitled matter, a copy of which is hereto attached, and has transmitted therewith the papers as shown in said Certificate.

Dated at Seattle, in said District, this 9th day of April, 1959.

/s/ VAN C. GRIFFIN,
Referee in Bankruptcy.

[Endorsed]: Filed April 9, 1959.

[Title of District Court and Cause.]

ORDER ADOPTING AND MODIFYING IN PART THE ORDER DETERMINING LIABILITY FOR TAXES OF THE UNITED STATES ENTERED BY THE REFEREE-SPECIAL MASTER ON FEBRUARY 9, 1959.

This matter having come on duly for hearing before the undersigned judge of the above entitled court at 10:00 o'clock a.m. on August 10, 1959, and being continued thereafter from time to time for further hearings at 9:45 o'clock a.m. on September 25, 1959, at

2:00 o'clock p.m. on March 1, 1960, at 2:00 o'clock p.m. on March 21, 1960 and 9:30 o'clock a.m. on May 6, 1960, upon the petition for review of the United States of America filed on February 18, 1959, seeking a review of the Findings of Fact and Conclusions of Law and Order Determining Liability for Taxes of the United States entered and filed by the Honorable Van C. Griffin, Referee-Special Master, on February 9, 1959, Richard D. Harris, the Trustee in the above entitled proceeding, being represented by Donald A. Schmechel, his attorney, and the United States of America being represented by Jacob A. Mikkelborg, Assistant United States Attorney, and Thomas R. Winter, Special Assistant to the Regional Counsel, Internal Revenue Service, and the court having considered the records and files herein, including those transmitted with the Referee's Certificate on Review dated April 8, 1959, and the Memoranda of Authorities filed by said attorneys for the Trustee and the United States of America, and the court having heard the arguments of said attorneys for the Trustee and the United States of America, and being duly advised in the premises, it is hereby

Ordered

1. That the Findings of Fact and Conclusions of Law and the Order Determining Liability for Taxes for the United States entered and filed by the Honorable Van C. Griffin, Referee-Special Master, on February 9, 1959 are modified to allow the United States of America to recover interest on the principal of all taxes owed

by the Alaska Telephone Corporation, debtor, through September 30, 1955, the date of filing of the original petition under Chapter XI of the Bankruptcy Act in these proceedings, without any deduction therefrom for interest on the monies held by the United States of America, pursuant to an offer and compromise made by said debtor prior to September 30, 1955, and said Findings and Order are further modified to indicate that the United States of America be and it hereby is determined to have properly filed a rejection of the amended plan of reorganization within 90 days after receipt of notice pursuant to Section 199 of the Bankruptcy Act, as amended.

2. That said Findings of Fact and Conclusions of Law and said Order of the Referee-Special Master entered and filed on February 9, 1959 is in all other respects adopted and confirmed, and specifically adopted and confirmed with respect to their determination that the United States of America is not entiled to any interest upon its tax claims after September 30, 1955, and is not entitled to recover any penalties regardless of whether they arose before or after September 30, 1955.

3. That Richard D. Harris, Trustee, is authorized and directed to pay such additional amounts as may be due the United States of America over and above the $57,000.00 heretofore paid upon its tax claims, unless an appeal or appeals are taken from this order, the additional amounts to be resolved by the attorneys for the said Trustee and the United States of America, and in

the event they are unable to agree on said amounts, this matter is recommitted to said Referee-Special Master for a determining of the amounts which may be due pursuant to the terms of this Order.

Dated this 16th day of May, 1960.

/s/ WILLIAM J. LINDBERG,
District Judge

Presented by:

/s/ DONALD A. SCHMECHEL
Attorney for
Richard D. Harris, Trustee

Approved as to form and
Notice of Presentation Waived:

/s/ THOMAS R. WINTER
Special Assistant to the
Regional Counsel,
Internal Revnue Service.

[Endorsed]: Filed May 10, 1960.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: Alaska Telephone Corporation, and

To: Wright, Innis, Simon & Todd, Donald A. Schmechel, Attorney for Trustee of the Debtor, Alaska Telephone Corporation.

Notice Is Hereby Given that the petitioner herein, United States of America, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the second enumerated ordering paragraph of the Final Order entered in the above-entitled action on the 10th day of May, 1960.

Dated this 6th day of June, 1960.

/s/ CHARLES P. MORIARTY,
United States Attorney.

/s/ JACOB A. MIKKELBORG,
Assistant United States Attorney,
Attorneys for United States of America.

[Endorsed]: Filed June 6, 1960.

[Title of District Court and Cause.]

ORDER EXTENDING TIME FOR FILING AND DOCKETING APPEAL

This Matter coming on regularly before the undersigned Judge of the above-entitled Court on motion of the United States Attorney for an order extending time for filing the record on the appeal noted on June 6, 1960, and docketing the said appeal, pursuant to the provisions made and provided by Federal Rules of Civil Procedure, Rule 73(g), and the Court having heard the statement of counsel for the United States and it appearing that sufficient cause has been shown for issuance of this order, now, therefore

It Is Hereby Ordered that the United States of America may have to and including September 4, 1960, which date is the ninetieth (90th) day from the date of filing the said Notice of Appeal.

Dated this 14th day of July, 1960.

/s/ WILLIAM J. LINDBERG,
United States District Judge.

Approved and Presented by:

/s/ JACOB A. MIKKELBORG,
Assistant United States Attorney.

Approved for Entry and
Notice of Presentation Waived:

/s/ DONALD A. SCHMECHEL,
Attorney for Richard D. Harris,
Trustee.

[Endorsed]: Filed July 14, 1960.

[Ttile of District Court and Cause.]

CERTIFICATE OF CLERK, UNITED STATES DISTRICT COURT, TO RECORD ON APPEAL.

United States of America, Western District of Washington—ss.

I, Harold W. Anderson, Clerk of the United States District Court for the Western District of Washington, do hereby certify that pursuant to the provisions of Subdivision I of Rule 10 as Amended, of the United States Court of Appeals for the Ninth Circuit, and Rule 75(o) of the Federal Rules of Civil Procedure, I am transmitting herewith all of the original papers in the file dealing with the proceeding as the record on appeal herein to the United States Court of Appeals at San Francisco, as designated by counsel, to-wit:

1. Notice of Filing Petition for Review.

2. Referee's Certificate on Review, filed April 9, 1959, including the following:

(a) Petition to Determine Proper Allowance of Claims of United States for Taxes and Objections Thereto. (Copies of proof of claim of the United States filed December 14, 1957, February 7, 1956 and January 17, 1956, labeled Exhibits "A", "B" and "C", respectively, and by reference incorporated therein.)

(b) Order Setting Hearing on Trustee's Petition to Determine Proper Allowance on Claims of United States of America.

(c) Affidavit of Donald A. Schmechel made January 26, 1959.

(d) The Amended Plan and the Judge's Orders thereon.

(e) Opinion of Referee-Special Master as to the tax claim of the United States of America.

(f) Findings of Fact and Conclusions of Law.

(g) Order Determining Liability for Taxes of the United States.

(h) Petition for Review.

3. Notice of Filing of Referee's Certificate, filed April 9, 1959.

4. Order Adopting and Modifying in Part the Order Determining Liability for Taxes of the United States entered by the Referee-Special Master on February 9, 1959.

5. Notice of Appeal filed June 6, 1960.

6. Order Extending Time for Filing and Docketing Appeal filed July 14, 1960.

7. Designation of Contents of Record on Appeal.

In Witness Whereof, I have hereunto set my hand and affixed the official seal of said District Court at Seattle, this 30th day of August, 1960.

HAROLD W. ANDERSON,
Clerk.

[Seal]

/s/ By JAMES M. BURKE,
Deputy.

[Endorsed]: No. 17066. United States Court of Appeals for the Ninth Circuit. United States of America, Appellant, vs. Richard D. Harris, Trustee for Alaska Telephone Corporation, Appellee. Transcript of Record. Appeal from the United States District Court for the Western District of Washington, Northern Division.

Filed and Docketed: August 31, 1960.

/s/ FRANK H. SCHMID,
Clerk of the United States Court of Appeals
for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit

No. 17066

UNITED STATES OF AMERICA, Appellant,

vs.

RICHARD D. HARRIS, Trustee, ALASKA TELEPHONE CORPORATION,

Debtor-Appellee.

STATEMENT OF POINTS UPON WHICH APPELLANT INTENDS TO RELY ON APPEAL

1. The Court erred in adopting and confirming that part of the Order of the Referee-Special Master entered and filed on February 9, 1959, wherein the Referee concluded that Section 57(j) of the Bankruptcy Act, as amended, prohibits payment and collection of penalties from bankrupt estates after institution of bankruptcy proceedings where the tax claims, including penalties, are secured by liens perfected prior to filing of petition under Chapter X proceedings in this cause; (Referee's Conclusion of Law 2.)

2. That the Court erred in concluding that Section 57(j) of the Bankruptcy Act, as amended, prohibits payment and collection of penalties from bankrupt estates after institution of bankruptcy proceeding where the tax claims, including penalties, are secured by liens perfected prior to filing of the petition under Chapter X proceedings, as in this cause;

3. That the Court erred in failing to enter judgment allowing and ordering paid the tax claims of the United

States, including penalties which were secured by liens perfected prior to the filing of the petition under Chapter X in this cause.

/s/ CHARLES P. MORIARTY,
United States Attorney.

/s/ JACOB A. MIKKELBORG,
Assistant United States Attorney.

/s/ THOMAS R. WINTER,
Special Assistant to the Regional Counsel, Internal Revenue Service.

[Endorsed]: Received Sept. 9, 1960.

[fol. 63a]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 17066

UNITED STATES OF AMERICA, Appellant,

vs.

RICHARD D. HARRIS, Trustee for Alaska Telephone Corporation, Appellee.

[fol. 64] Before: Chambers, Hamley and Merrill, Circuit Judges.

MINUTE ENTRY OF ARGUMENT AND SUBMISSION —January 5, 1961

This cause coming on regularly for hearing and submission Mr. Karl Schmeidler, Attorney, Dept. of Justice, argued for the Appellant and Mr. Donald A. Schmechel, argued for the appellee, and thereupon, the court ordered this cause submitted for consideration and decision.

[fol. 65]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MINUTE ENTRY OF ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT—February 1, 1961

Ordered that the typewritten opinion this day rendered by this Court in above cause be forthwith filed by the clerk and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion rendered.

[fol. 66] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 17,066

UNITED STATES OF AMERICA, Appellant,

vs.

RICHARD D. HARRIS, Trustee for Alaska Telephone Corporation, Appellee.

Upon Appeal From the United States District Court for the Western District of Washington Northern Division

---

OPINION—February 1, 1961

Before: Chambers, Hamley and Merrill, Circuit Judges.

Per Curiam:

This appeal involves lien claims in the sum of $7,714.72, asserted by the United States against properties of the Alaska Telephone Corporation, a debtor in reorganization under Chapter X of the Bankruptcy Act. The claim is for penalties imposed on unpaid federal taxes and was disallowed by the Referee in Bankruptcy as in conflict with § 57(j) of the Bankruptcy Act, 11 U.S.C. § 93. Upon review, the ruling of the referee was affirmed by the District Court and the United States has taken this appeal.

The precise point involved was presented to this court in Simonson vs. Granquist, opinion handed down this day, with which case the instant case was consolidated for purposes of argument. For the reasons set forth in that opinion, we hold the rulings of the referee and the District Court to be error.

Reversed and remanded with instructions that the lien claim of the United States be allowed as a secured claim against the properties of the debtor corporation.

[fol. 67] [File endorsement omitted]

IN UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 17066

UNITED STATES OF AMERICA, Appellant,

vs.

RICHARD D. HARRIS, Trustee, etc., Appellee.

JUDGMENT—Filed and Entered February 1, 1961

Appeal from the United States District Court for the Western District of Washington, Northern Division.

This Cause came on to be heard on the Transcript of the Record from the United States District Court for the Western District of Washington, Northern Division and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is reversed and remanded, with instructions that the lien claim of the United States be allowed as a secured claim against the properties of the debtor corporation.

[fol. 68]

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MINUTE ENTRY OF ORDER DENYING PETITION FOR REHEARING —March 13, 1961

On consideration thereof, and by direction of the Court, It Is Ordered that the petition of appellee, filed March 7, 1961 and within time allowed therefor by rule of court, for a rehearing of above cause be, and hereby is, denied.

[fol. 69] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 70]

SUPREME COURT OF THE UNITED STATES

No. 919, October Term, 1960

HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy, etc., et al., Petitioners,

vs.

R. C. GRANQUIST, District Director of Internal Revenue, et al.

ORDER ALLOWING CERTIORARI—June 5, 1961

The petition herein for a writ of certiorari to the United States Court of Appeals for the Ninth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

In the

Supreme Court of the United States

OCTOBER TERM, 1960

HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy of the Estate of Max L. Druxman, Bankrupt, *Petitioner*,
vs.
R. C. GRANQUIST, District Director of the Internal Revenue Service, *Respondent*.

RICHARD D. HARRIS, Trustee for Alaska Telephone Corporation, *Petitioner*,
vs.
UNITED STATES OF AMERICA, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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No. .....

In the

Supreme Court of the United States

OCTOBER TERM, 1960

HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy of the Estate of Max L. Druxman, Bankrupt, *Petitioner*,

vs.

R. C. GRANQUIST, District Director of the Internal Revenue Service, *Respondent*.

RICHARD D. HARRIS, Trustee for Alaska Telephone Corporation, *Petitioner*,

vs.

UNITED STATES OF AMERICA, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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CITATIONS

STATUTES

In the

Supreme Court of the United States

OCTOBER TERM 1960

HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy of the Estate of Max L. Druxman, Bankrupt, *Petitioner*,
vs.
R. C. GRANQUIST, District Director of the Internal Revenue Service, *Respondent*.

RICHARD D. HARRIS, Trustee for Alaska Telephone Corporation, *Petitioner*,
vs.
UNITED STATES OF AMERICA, *Respondent*.

No. .....

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners pray that writs of certiorari issue to review the Court of Appeals' judgments entered February 1, 1961, in both of the above entitled cases, which cases were consolidated for purposes of argument before the United States Court of Appeals for the Ninth Circuit.

CITATIONS TO OPINIONS BELOW

A. *Simonson v. Grandquist:*

In *Simonson v. Granquist,* the Referee's Findings and Conclusions, Referee's Order and Order of the District Court for the District of Oregon are unreported, but are fully set forth in the Transcript of Record (R. 7, 22 and 27). The Court of Appeals' opin-

ion (R. 34-37), Appendix A, *infra*, pp. 12-17, is to date unreported.

B. *Harris v. United States of America:*

In *Harris v. United States of America*, the Referee's Opinion, Findings of Fact and Conclusions of Law, and Order Determining Liability for Taxes of the United States, and the Order Adopting and Modifying in Part the Order Determining Liability for Taxes of the United States as entered by the District Court for the Western District of Washington are unreported, but are fully set forth in the Transcript of Record (R. 33, 38, 41, 46 and 54). The Court of Appeals' opinion (R. 66), which adopts the reasons set forth in that Court's opinion in *Simonson v. Granquist* (R. 34-37), Appendix A, *infra*, p. 18, is to date unreported.

JURISDICTION

A. *Simonson v. Grandquist:*

The Court of Appeals' judgment in *Simonson v. Granquist* was entered February 1, 1961 (R. 38; Appendix B hereto, *infra*, p. 19). Petition for Rehearing, filed March 2, 1961, was denied March 13, 1961 (R. 38a). Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1), and 11 U.S.C. § 47.

B. *Harris v. United States of America:*

The Court of Appeals' judgment in *Harris v. United States of America* was entered February 1, 1961 (R. 67; Appendix B hereto, *infra*, p. 20). Petition for Rehearing, filed March 7, 1961, was denied March 13, 1961 (R. 68). Jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1), and 11 U.S.C. § 47.

QUESTIONS PRESENTED FOR REVIEW

A. *Simonson v. Granquist:*

In *Simonson v. Granquist,* the questions presented for review are as follows:

1. Is the trustee in bankruptcy a "judgment creditor" within the purview of Section 6323(a) of the Internal Revenue Code of 1954 so that the United States does not have a valid tax lien as against the trustee in bankruptcy where its tax assessments and the demand for payment are made prior to the filing of the petition in bankruptcy, but notice of the tax lien was not filed until after the petition in bankruptcy had been filed?

2. Is an addition to a federal tax imposed as a penalty by statute, and which became a secured claim against the property of the taxpayer and for which a lien arose in favor of the United States prior to the petition in bankruptcy, properly allowable as a secured claim against the bankrupt's estate, or is such claim disallowed by the operation of Section 57(j) of the Bankruptcy Act, as amended?

B. *Harris v. United States of Amercia:*

In *Harris v. United States of America,* the sole question presented is as follows:

Is an addition to a federal tax imposed as a penalty by statute, and which became a secured claim against the property of the taxpayer and for which a lien arose and notices of lien were filed prior to the filing of a petition in reorganization, properly allowable as a secured claim against the debtor's estate, or is such claim disallowed by the operation of Section 57(j) of the Bankruptcy Act, as amended?

STATUTES INVOLVED

Neither of the cases presented involve any constitutional provisions, treaties, ordinances or regulations.

A. *Simonson v. Granquist:*

In *Simonson v. Granquist,* portions of Sections 6321, 6322, and 6323 of the 1954 Internal Revenue Code, and portions of Sections 1, 2, 57(j), 64, 67, and 70 of the Bankruptcy Act, as amended, are involved. All of the applicable portions thereof, together with citations to the volume and page where they may be found in the official editions, are set forth verbatim in Appendix C, *infra,* pp. 21-28.

B. *Harris v. United States of Amercia:*

In *Harris v. United States of America,* only Sections 57(j) and 67(b) of the Bankruptcy Act, as amended, are involved. They are both set forth verbatim, together with citations to the volume and page where they may be found in the official editions, in Appendix C, *infra,* pp. 22, 23-24.

STATEMENT OF THE CASES

A. *Simonson v. Granquist:*

The following is a statement of the case of *Simonson v. Granquist*:

Upon the trustee's application, the referee ruled upon the allowance of certain secured claims of the United States for penalties and post-bankruptcy interest. The facts are not in dispute and, as found by the referee, may be stated as follows (R. 7-8):

The bankrupt was in the business of a small retail

jeweler, and the trustee was able to realize more than $8,000 upon liquidation of the business assets. This sum was sufficient to pay all tax claims and expenses of administration (R. 7).

The Director of Internal Revenue filed various claims in the bankruptcy proceeding for income, employment and excise taxes accruing prior to bankruptcy and owing by the bankrupt. The trustee paid $4,932.41 of taxes owing but disputed liability for $1,442.41 of penalties and $182.49 of post-bankruptcy interest (R. 6-8).

The taxes and penalties involved were assessed against Druxman on September 6, 1957, and a statement of tax due and demand for payment was issued ten days later. Druxman filed a voluntary petition in bankruptcy on October 18, 1957. The notice of tax lien was filed by the District Director of Internal Revenue on October 31, 1957 (R. 7).

The United States asserted its claim for taxes, penalties and interest as a secured creditor by virtue of its pre-existing lien and not as a priority unsecured creditor (R. 8).

The referee held that the federal tax lien was perfected against the trustee where the tax had been assessed and demand for payment had been made upon the taxpayer prior to bankruptcy although notice of the lien was not filed until after the filing of the petition in bankruptcy (R. 9-11). The referee also held that Section 57(j) of the Bankruptcy Act applies only to unsecured claims and does not disallow the payment of penalties on a tax lien (R. 11-13). Finally, the ref-

eree held that the United States was not entitled to post-bankruptcy interest (R. 13-21).

The trustee petitioned the District Court for review of the referee's order insofar as it allowed the United States penalties included in its claim based on a federal tax lien[1] (R. 28-29). The District Court affirmed the order of the referee (R. 27-28). The trustee then appealed to the United States Court of Appeals for the Ninth Circuit, which Court affirmed the order of the District Court (R. 34-37; Appendix A, *infra*, pp. 13-17). This petition follows.

B. *Harris v. United States of Amercia:*

The following is a statement of the case of *Harris v. United States of America*:

The Alaska Telephone Corporation, the taxpayer and debtor herein, filed a petition for a reorganization under Chapter X of the Bankruptcy Act, as amended, as of September 30, 1955.[2] The filing of this petition was approved by the District Court on November 21, 1955 (R. 33-34).

The United States filed proofs of claims for unpaid taxes with the trustee. Included in its claims and insofar as it is relevant to this proceeding are unpaid

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[1] The United States also petitioned to the District Court for review of the referee's order insofar as it disallowed the payment of post-bankruptcy interest (R. 24-25, 27). The District Court affirmed the referee. The United States did not petition for review of the District Court's order, and this issue is not involved on appeal.

[2] Initially this petition was filed on September 30, 1955, under Chapter XI of the Bankruptcy Act relating to proceedings in arrangements. However, it subsequently was amended to bring the proceedings under Chapter X dealing with corporate reorganizations (R. 30).

F.I.C.A. and telephone and telegraph excise taxes for 1952 and 1953 in the amount of $56,382.93, pre-petition interest in the amount of $1,056.28 and penalties imposed on such unpaid taxes in the amount of $7,714.72, for which the United States obtained liens in 1953 and filed notices of its liens in 1953 and 1954, prior to the time the debtor filed its petition in reorganization. Also, included in its claims are $182.86 of unpaid federal unemployment taxes for which a lien did not arise until 1956 and for which the United States did not seek to obtain interest or penalties[3] (R. 13-20, 39-40).

Prior to the filing of the petition in reorganization the taxpayer submitted an offer in compromise of $40,000 to settle the taxes involved and deposited that amount with the District Director of Internal Revenue between June 7, 1954, and August 19, 1955. Upon the filing of the petition for a reorganization the offer

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[3] The United States filed three proofs of claim for unpaid taxes. Its proof of claim, number 16½, was for $65,559.43, of which $405.50 was abated as being collectible, leaving a net amount of $65,153.93. This claim comprised $56,565.79 of unpaid taxes, $7,714.72 of penalties on the unpaid taxes and $1,056.28 of assessed interest, plus pre-petition interest for which liens arose and notices of liens were filed prior to the reorganization proceedings (R. 17-19). These amounts conform to those found by the referee (R. 39) and confirmed by the District Court (R. 56).

The proof of claim of the United States, number 23, was for $301.73 of unpaid federal unemployment taxes for 1953. The lien for this amount arose after the filing of the petition in reorganization and no penalties or interest were claimed (R. 16). This claim was allowed for $182.86. The amount of $63,336.79, set out in the petition for review to the District Court (R. 9, 52) includes both the $63,153.93 of liened claims covered by claim number 16½ and the $182.86 of unliened claims covered by claim number 23.

The proof of claim of the United States, number 51, was for $807.37 of unpaid withholding taxes for the period ended December 31, 1955, liability for which was incurred by the trustee. This amount was paid in full by the trustee in December, 1957, and is no longer in issue (R. 13, 15).

was withdrawn and the money was returned to the trustee on January 17, 1956 (R. 40).

A plan of reorganization was filed which, as amended, was submitted to the District Court for approval which provided, among other things, for payment of $57,000 in full settlement of the debtor's federal tax liabilities (R. 23-29, 38). The sum of $57,000 has been paid by the trustee to the District Director and is being held in a suspense account pending the outcome of these proceedings (R. 40). Notice was served upon the Secretary of the Treasury to accept or reject the amended plan (R. 32-33), and on December 26, 1958, the Acting Secretary of the Treasury, Julian A. Baird, filed a notice of rejection of the trustee's plan of reorganization with the clerk of the District Court.

Following the happening of the above-mentioned matters the trustee filed objections to the claims of the United States (R. 13-20), which objections were heard before the referee in bankruptcy who was also designated as a special master. The referee held that the Secretary of the Treasury failed to reject properly the proposed plan of reorganization and therefore was conclusively presumed to have accepted it, and that the claims of the United States were fully satisfied by payment of the $57,000. The referee also held that the trustee was entitled to a credit against the claim of the United States for interest in the amount of $3,863.81 on the $40,000 deposited by the debtor under the offer in compromise. Finally, the referee held that the United States was not entitled to obtain assessed or other pre-petition or post-petition interest or penalties on its secured claims (R. 34-37, 40, 41-45, 46).

Upon a petition for review filed by the United States (R. 4-10, 47-53) the District Court modified the order of the referee and held that the United States had properly rejected the amended plan of reorganization, that the claims of the United States should not be reduced for interest on moneys held by it pursuant to an offer in compromise, and that the United States was entitled to pre-petition interest on the principal of all taxes owed by the debtor. However, the District Court affirmed the order of the referee insofar as it disallowed the recovery of penalties and post-petition interest on the secured claims of the United States (R. 55-57). The United States has appealed to this Court from the disallowance of the portion of its claim for penalties (R. 58, 62-63). The United States of America then appealed to the United States Court of Appeals for the Ninth Circuit, which Court reversed and remanded the order of the District Court (R. 66; Appendix A, *infra*, pp. 13-17). This petition follows.

C. Original Jurisdiction:

Jurisdiction over both cases herein presented was originally vested in the respective District Courts pursuant to the provisions of 11 U.S.C. §§ 1(10), 11(a) and 11(a)(11). Jurisdiction over both cases herein presented was vested in the United States Court of Appeals for the Ninth Circuit pursuant to the provisions of 28 U.S.C. § 1291 and 11 U.S.C. § 47.

REASONS FOR GRANTING WRITS

The following reasons for granting the writs are common to both cases here presented:

1. The decision of the United States Court of Appeals for the Ninth Circuit in these cases, regarding the construction of Section 57(j) of the Bankruptcy Act, 11 U.S.C. § 93, as it affects liened claims of the United States of America for penalties on unpaid taxes, is in direct conflict with the recent decisions of the Fourth and Fifth Circuit Courts of Appeal in *United States v. Harrington,* Fourth Circuit, 1959, 269 F.2d 719; *United States v. Phillips,* Fifth Circuit, 1959, 267 F.2d 374; and with decisions by a number of District Courts including: *In re Burch,* 89 F.Supp. 249 (Kans.); *In re Hankey Baking Co.,* 125 F.Supp. 673 (W.D. Pa.); *In re Lykens Hosiery Mills,* 141 F.Supp. 895 (S.D. N.Y.); and *In re Parchem,* 166 F.Supp. 724 (Minn.). It is believed that the decision of the United States Court of Appeals for the Ninth Circuit in these cases, while being consistent with that Circuit's prior decision of *In re Knox-Powell-Stockton Co.,* 100 F.2d 979, and the decisions from the Sixth and Tenth Circuits in *Commonwealth of Kentucky v. Farmers Bank & Trust Co.,* Sixth Circuit, 1943, 139 F.2d 266; *Grimland v. United States,* Tenth Circuit, 1953, 206 F.2d 599; and *United States v. Mighell,* Tenth Circuit, 1959, 273 F.2d 682, is not only in direct conflict with the cases from the Fourth and Fifth Circuits, cited above, but also in direct conflict with statements from *Gardner v. State of New Jersey,* 329 U.S. 565, 67 S.Ct. 467, 475, 91 L.Ed. 504; and, from *Pepper v. Litton,* 308 U.S. 295, 84 L.Ed. 281, 60 S.Ct. 238.

2. The decision of the United States Court of Appeals for the Ninth Circuit in these cases has far-reach-

ing implications beyond the effect felt by the immediate parties hereto, in that the same question is presented to a great many trustees in bankruptcy in proceedings throughout the United States, and although the United States of America has twice had the opportunity to seek certiorari, following the decisions in *United States v. Harrington, supra,* and *United States v. Phillips, supra,* its failure to do so has placed the burden upon the estates of bankrupts and debtors to seek resolution of this problem.

The following reason for granting the writ in the case of *Simonson v. Granquist* is applicable to that case only:

In *United States v. Gilbert Associates,* 345 U.S. 361, 97 L.Ed. 1071, 73 S.Ct. 701, the question presented was whether or not the Town of Walpole, New Hampshire, occupied the role of a judgment creditor under the provisions of § 3672 of the Internal Revenue Code, 56 Stat. 798, 26 U.S.C. § 3672. In holding that the town was not a judgment creditor for these purposes, the Supreme Court was not construing the provisions of the Bankruptcy Act enacted by Congress for the benefit of trustees in bankruptcy, and these provisions, which control the determination of the first question presented in this case, should now be construed. The need for this determination is evidenced by the concurring opinion of Circuit Judge Hamley in this decision (R. 36-37; Appendix A, *infra,* pp. 16-17), and by the dissenting opinion of Circuit Judge Kalodner, joined in by Judge Hastie, filed in *In re Fidelity Tube Corporation,* Third Circuit, 278 F.2d 776, petition for writ of certiorari pending.

CONCLUSION

We respectfully urge that this Petition for Certiorari be granted as to both cases covered hereby.

Respectfully submitted,

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APPENDIX A

OPINIONS OF COURT OF APPEALS

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy of the Estate of Max L. Druxman, Bankrupt, *Appellant*, vs. R. C. GRANQUIST, District Director of the Internal Revenue Service, *Appellee*.	No. 16,878 Feb. 1, 1961

Upon Appeal from the United States District Court for the District of Oregon

Before: CHAMBERS, HAMLEY and MERRILL, Circuit Judges

PER CURIAM:

This appeal is taken by the trustee of a bankrupt estate from the judgment of the District Court affirming an order of the Referee in Bankruptcy which allowed the United States a lien claim against the bankrupt estate in the sum of $1,442.41 for penalties on unpaid federal taxes.

Two questions are presented by this appeal.

The first question concerns the significance of the fact that although the lien of the United States arose prior to the filing of a petition in bankruptcy, notice of such lien was not filed until after the filing of the petition in bankruptcy. The trustee contends that under § 6323 of the Internal Revenue Code of 1954, 26 U.S.C. § 6323, the lien of the United States under these circumstances is invalid.

Section 6323 provides that the tax lien of the United States "shall not be valid as against a mortgagee, pledgee, purchaser or judgment creditor unless notice thereof has been filed" in certain specified public offices.

Section 70 of the Bankruptcy Act, 11 U.S.C. § 110, provides in part:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

The trustee contends that under § 70 he is by operation of law made a judgment creditor of the bankrupt; that under § 6323 of the Internal Revenue Code, as a judgment creditor, the lien of the United States is rendered invalid as to him.

The Supreme Court has interpreted § 6323 as limiting the class of persons who take priority over the unrecorded tax liens of the United States to judgment creditors (or purchasers, mortgagees or pledgees) in the conventional and ordinary sense of the words. United States v. Gilbert Associates, 1953, 345 U.S. 361; United States v. Security Trust and Savings Bank, 1950, 340 U.S. 47, 52.

The precise question presented by the instant case was presented to this court in United States v. England, 9 Cir., 1955, 226 F.2d 205. We there held that a trustee in bankruptcy could not, in the light of the Supreme Court's construction of the section, claim the status of judgment creditor under § 6323. Other courts

have reached the same result. In re Fidelity Tube Corporation, 3 Cir., 1960, 278 F.2d 776; Brust v. Sturr, 2 Cir., 1956, 237 F.2d 135; see In re Tailorcraft Aviation Corporation, 6 Cir., 1948, 168 F.2d 808.

We adhere to our ruling in United States v. England and accordingly reject this contention of the trustee.

The second question presented by this appeal is whether a claim of the United States for penalties on unpaid taxes, upon which claim a lien arose prior to bankruptcy, is barred by § 57(j) of the Bankruptcy Act, 11 U.S.C. § 93:

> "Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law."

While the courts have divided upon this question, this court has held that § 57(j) does not apply to secured claims. In re Knox-Powell-Stockton Company, 9 Cir., 1939, 100 F.2d 979. To the same effect are United States v. Mighell, 10 Cir., 1959, 273 F.2d 682; Kentucky v. Farmers Bank, 6 Cir., 1943, 139 F.2d 266. Cases contrary to this court's position are: United States v. Harrington, 4 Cir., 1959, 269 F.2d 719; United States v. Phillips, 5 Cir., 1959, 267 F.2d 374.

We adhere to our ruling in Knox-Powell-Stockton and accordingly reject the contention of the trustee that § 57(j) invalidates the secured claim of the United States in this matter.

Affirmed.

HAMLEY, Circuit Judge (concurring):

Under section 6323(a) of the Internal Revenue Code of 1954, 26 U.S.C.A. § 6323(a), a tax lien of the United States is not valid against a "judgment creditor" until notice thereof has been filed. The notice of the lien here in question was not filed until after the bankrupt's property came into the possession or control of the bankruptcy court. Thus, if the trustee stands in the position of a judgment creditor within the meaning of section 6323, the lien is not valid as to the trustee.

Under section 70(c) of the Bankruptcy Act, 11 U.S.C.A. § 110(c), a trustee in bankruptcy is deemed to be vested as of the date particular property comes into the possession or control of the court, with "all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists." In my view this statute states as clearly as words can speak that a trustee is to be treated *as if* he were a judgment creditor, although obviously he is not one.

As pointed out in the majority opinion, several courts, including this one, have denied the trustee this section 70(c) status. They have done so because in United States v. Gilbert Associates, 345 U.S. 361, 364, it was stated that section 3672(a) of the Internal Revenue Code, 56 Stat. 798, 26 U.S.C.A. (1946 ed.) § 3672 (a), which was similar to section 6323(a) of the Internal Revenue Code of 1954 used the words "judgment creditor" in "the usual conventional sense of a judgment of a court of record, since all states have such courts."

This statement was made in Gilbert Associates in rejecting a contention that a New Hampshire statute which declared a tax assessment to be in the nature of a judgment had the effect of giving city tax liens judg-

ment creditor status under the then section 3672(a). The Supreme Court thus denied to the states and local governments the right to appropriate to themselves by statutory fiat a defense against United States liens which the United States originally intended to be applicable only with respect to ordinary judgment creditors.

But the Supreme Court did not say, and had no reason to say, that Congress could not make available to trustees in bankruptcy a defense which it originally made available only to judgment creditors. The defense having been created by act of Congress, the same legislative body was free to extend its benefits however it pleased. I am thus in full agreement with the very exhaustive dissenting opinion of Judge Kalodner, joined in by Judge Hastie, filed in In re Fidelity Tube Corporation, 3 Cir., 278 F.2d 776, petition for writ of certiorari pending.

If the question discussed above were now before this court for the first time I would accordingly vote to reverse. Since, however, this court adopted a contrary view in United States v. England, 9 Cir., 226 F.2d 205, and Congress may, if it chooses, overturn that ruling for the future by enacting clarifying legislation, I am content to note the above views by way of a concurring opinion.

(Endorsed) Per Curiam Opinion and Concurring Opinion Filed Feb. 1, 1961.

Frank H. Schmid, Clerk.

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, *Appellant*, vs. RICHARD D. HARRIS, Trustee for Alaska Telephone Corporation, *Appellee*.	No. 17,066 Feb. 1, 1961

Upon Appeal from the United States District Court for the Western District of Washington Northern Division

Before: CHAMBERS, HAMLEY and MERRILL, Circuit Judges

PER CURIAM:

This appeal involves lien claims in the sum of $7,714.72, asserted by the United States against properties of the Alaska Telephone Corporation, a debtor in reorganization under Chapter X of the Bankruptcy Act. The claim is for penalties imposed on unpaid federal taxes and was disallowed by the Referee in Bankruptcy as in conflict with § 57(j) of the Bankruptcy Act, 11 U.S.C. § 93. Upon review, the ruling of the referee was affirmed by the District Court and the United States has taken this appeal.

The precise point involved was presented to this court in Simonson vs. Granquist, opinion handed down this day, with which case the instant case was consolidated for purposes of argument. For the reasons set forth in that opinion, we hold the rulings of the referee and the District Court to be error.

Reversed and remanded with instructions that the lien claim of the United States be allowed as a secured claim against the properties of the debtor corporation.

(Endorsed) Per Curiam Opinion Filed Feb. 1, 1961.

Frank H. Schmid, Clerk.

APPENDIX B

JUDGMENTS OF THE COURT OF APPEALS

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

HATTIEBELLE O. SIMONSON, ETC., *Appellant*, vs. R. C. GRANQUIST, ETC., *Appellee*.	No. 16878

JUDGMENT

Appeal from the United States District Court for the District of Oregon.

This Cause came on to be heard on the Transcript of the Record from the United States District Court for the District of Oregon and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is affirmed.

(ENDORSED) Judgment

Filed and entered February 1, 1961,

Frank H. Schmid, Clerk.

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, *Appellant*, vs. RICHARD D. HARRIS, TRUSTEE, ETC., *Appellee*.	No. 17066

JUDGMENT

Appeal from the United States District Court for the Western District of Washington, Northern Division.

This Cause came on to be heard on the Transcript of the Record from the United States District Court for the Western District of Washington, Northern Division and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause be, and hereby is reversed and remanded, with instructions that the lien claim of the United States be allowed as a secured claim against the properties of the debtor corporation.

(ENDORSED) Judgment

Filed and entered February 1, 1961,

Frank H. Schmid, Clerk.

APPENDIX C

STATUTES INVOLVED

Bankruptcy Act, c. 541, 30 Stat. 544:

Sec. 7. [As amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840] MEANING OF WORDS AND PHRASES. The words and phrases used in this Act and in proceedings pursuant hereto shall, unless the same be inconsistent with the context, be construed as follows: * * *

(10) "Courts of bankruptcy" shall include the United States district courts and the district courts of the Territories and possessions to which this Act is or may hereafter be applicable.

* * * * *

(11 U.S.C. 1952 ed. Sec. 1(10))

Sec. 2 [As amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840] CREATION OF COURTS OF BANKRUPTCY AND THEIR JURISDICTION.—a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * * * *

(20) Exercise ancillary jurisdiction over persons or property within their respective territorial limits in aid of a receiver or trustee appointed in any bankruptcy proceedings pending in any other court of bankruptcy: *Provided, however,* That the jurisdiction of the ancillary court over a bankrupt's property which it

takes into its custody shall not extend beyond preserving such property and, where necessary, conducting the business of the bankrupt, and reducing the property to money, paying therefrom such liens as the court shall find valid, and the expenses of ancillary administration, and transmitting the property or its proceeds to the court of primary jurisdiction; * * *

* * * * *

(11 U.S.C. 1952 ed., Sec. 29.)

SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * * * *

j [As amended by Sec. 14(a), Act of July 7, 1952, c. 579, 66 Stat. 420]. Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.

* * * * *

(11 U.S.C. 1952 ed, Sec. 93.)

SEC 64 [As amended by Sec. 1, Act of June 22, 1938, *supra*, and Sec. 19(a), Act of July 7, 1952, *supra*] DEBTS WHICH HAVE PRIORITY.—a. The debt to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * * (2) wages not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceding, * * * (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the

objection and through the efforts and at the cost and expense of one or more creditors, * * * the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [*sic*] entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

* * * * * *

(11 U.S.C. 1952, ed., Sec. 104)

SEC. 67 [As amended by Sec. 1, Act of June 22, 1938, *supra,* and Sec. 21(b) and (c), Act of July 7, 1952, *supra*]. LIENS AND FRAUDULENT TRANSFERS.—a. * * *

b. The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or to any State or any subdivision thereof, created or recognized by the laws of United States or of any State, may be valid against the trustee, even though arising or perfected while the

debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead by perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition initiating a proceeding under this Act, and except where the estate of the bankrupt is solvent: (1) though valid against the trustee under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or any subdivision thereof, on personal property not accompanied by possession of such property, and liens, whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act; and (2) the provisions of subdivision b of this section to the contrary notwithstanding, statutory liens created or recognized by the laws of any State for debts owing to any person, including any State or any subdivision thereof, on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such property, shall not be valid against the trustee: *Provided, however,* That so much of clause (1) of this subdivision c as restricts liens for wages and rent and clause (2) of this subdivision c shall not apply in proceedings under chapter X of this Act, unless an order

shall be entered therein directing that bankruptcy be proceeded with, or in proceedings under section 77 of this Act. The court may on due notice order so much of any lien in excess of the restricted amount under clause (1) and any lien invalid under clause (2) of this subdivision c to be preserved for the benefit of the estate, and, in any such event, such lien for the excess and such invalid lien, as the case may be, shall pass to the trustee.

* * * * *

(11 U.S.C. 1952 ed., Sec. 107.)

Sec. 70 [As amended by Sec. 23(a) and (c), Act of July 7, 1952, *supra*]. TITLE TO PROPERTY.

a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located * * *

* * * * *

c. The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

* * * * *

(11 U.S.C. 1952 ed., Sec. 110.)

Internal Revenue Code of 1954

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1958 ed., Sec. 6321)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C. 1958 ed., Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.* In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of district court.* In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) *With clerk of district court for District of Columbia.* In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

* * * * *

(d) *Disclosure of Amount of Outstanding Lien.* If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

(26 U.S.C. 1958 ed., Sec. 6323.)

Judiciary and Judicial Procedure

Sec. 1254. Courts of appeal; certiorari; appeal; certified questions.

Cases in the courts of appeals may be reviewed by the Supreme Court by the following methods:

(1) By writ of certiorari granted upon the petition of any party to any civil or criminal case, before or after rendition of judgment or decree; * * *

(28 U.S.C. 1952 ed. Sec. 1254(1))

Sec. 1291 Final decisions of district courts.

The courts of appeals shall have jurisdiction of appeals from all final decisions of the district courts of the United States, the District Court for the Territory of

Alaska, the United States District Court for the District of the Canal Zone, and the District Court of the Virgin Islands, except where a direct review may be had in the Supreme Court.

June 25, 1948, c. 646, 62 Stat. 929.

(28 U.S.C. 1952 ed. Sec. 1291.)

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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1960

No. 919

HATTIEBELLE O. SIMONSON, TRUSTEE IN BANKRUPTCY OF THE ESTATE OF MAX L. DRUXMAN, BANKRUPT, PETITIONER

v.

R. C. GRANQUIST, DISTRICT DIRECTOR OF THE INTERNAL REVENUE SERVICE

RICHARD D. HARRIS, TRUSTEE FOR ALASKA TELEPHONE CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENTS

I

Section 57j of the Bankruptcy Act provides that debts "owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed" (with an exception not here applicable) as provable claims. Each of these cases

presents the question whether this provision applies to bar the allowance in bankruptcy of a secured claim by the United States for penalties on federal taxes, on which a lien had arisen prior to bankruptcy. The court of appeals, following its prior decision that Section 57j does not apply to secured claims (*In re Knox-Powell-Stockton Co.*, 100 F. 2d 979, 983–984), held that the district court had properly allowed the United States a lien claim against the bankrupt estate for such penalties.

As the court of appeals recognized (Pet. 15), its decision on this issue is in conflict with *United States* v. *Harrington*, 269 F. 2d 719 (C.A. 4) and *United States* v. *Phillips*, 267 F. 2d 374 (C.A. 5). On the other hand, the Sixth and the Tenth Circuits are in accord with the decision below.[1] The question is an important one in the administration of the Internal Revenue laws.[2] The Chief Counsel of the Internal Revenue Service has advised us that there are 3,397 cases pending under the Bankruptcy Act involving lien claims for penalties on federal taxes, which total $2,580,571.79. In view of the conflict and the importance of the question, the government does not oppose certiorari on this issue (the second question pre-

[1] *Commonwealth of Kentucky* v. *Farmers Bank & Trust Co.*, 139 F. 2d 266 (C.A. 6); *Grimland* v. *United States*, 206 F. 2d 599 (C.A. 10); *United States* v. *Mighell*, 273 F. 2d 682, 684 (C.A. 10); see *Laughorn* v. *Carter*, 19 Cal. 2d 454, 121 P. 2d 738.

[2] The question is also important in the administration of state and local tax laws, since Section 57j covers debts due both to the United States and to states and subdivisions thereof. Indeed, the penalties involved in the *Knox-Powell* and *Commonwealth of Kentucky* cases (text and note 1, *supra*) arose out of state taxes.

II

sented in *Simonson*, and the only question in *Harris*).

Although the tax lien in *Simonson* arose before the petition in bankruptcy was filed, notice of such lien was not filed until after the petition. Section 70c of the Bankruptcy Act provides that the trustee shall be deemed vested, as of the date of bankruptcy, with all the rights, remedies and powers of a judicial lien creditor, whether or not such creditor actually exists. Section 6323(a) of the Internal Revenue Code of 1954 provides that a federal tax lien "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor unless notice thereof has been filed * * *." The petitioner in the *Simonson* case (the trustee in bankruptcy) contends that the effect of these two provisions taken together is to give him the status of a "judgment creditor," and hence to invalidate, as against him, a federal tax lien as to which notice had not been filed prior to bankruptcy.

We submit that the court of appeals correctly rejected this contention, and that further review of this question is unwarranted.

Both this Court and the lower federal courts have consistently interpreted Section 6323(a) of the 1954 Code, and the predecessor provision of the 1939 Code (Section 3672(a)), as using the terms judgment creditor, purchaser, mortgagee, and pledgee, in their "usual, conventional sense" (*United States* v. *Gilbert Associates*, 345 U.S. 361, 364). Under these standards, a "judgment creditor" within the meaning of these provisions is someone holding a judgment of a court

of record, and a "purchaser" is someone who has acquired title for a valuable consideration in the manner of vendor and vendee. *United States* v. *Gilbert Associates*, 345 U.S. 361, 364 (judgment creditor); concurring opinion of Mr. Justice Jackson in *United States* v. *Security Tr. & Sav. Bk.*, 340 U.S. 47, 52 (judgment creditor); *United States* v. *Scovil*, 348 U.S. 218, 221 (purchaser); *United States* v. *Ball Construction Co.*, 355 U.S. 587 (mortgagee); United *States* v. *Hawkins*, 228 F. 2d 517 (C.A. 9) (purchaser); *New York Terminal Warehouse Co.* v. *Bullington*, 213 F. 2d 340, 344 (C.A. 5) (purchaser); *United States* v. *Chapman*, 281 F. 2d 862, 868-869 (C.A. 10) (purchaser); *National Refining Co.* v. *United States*, 160 F. 2d 951, 955 (C.A. 8) (purchaser). See S. Rep. No. 1622, 83d Cong., 2d Sess., p. 575.

Applying these settled principles, every lower federal court that has considered the question has held that the provision in Section 70c of the Bankruptcy Act giving the trustee the status of a hypothetical judicial lien creditor does not make him a "judgment creditor" within the meaning of Section 6323(a) of the 1954 Code or its 1939 Code predecessor. *United States* v. *England*, 226 F. 2d 205 (C.A. 9); *Brust* v. *Sturr*, 237 F. 2d 135 (C. A. 2); *Matter of Fidelity Tube Corp.*, 278 F. 2d 776 (C.A. 3), certiorari denied, *sub nom. Borough of East Newark* v. *United States*, 364 U.S. 828; *In re Taylorcraft Aviation Corp.*, 168 F. 2d 808, 810 (C.A. 6); *In the Matter of Green*,

124 F. Supp. 481 (N.D. Ala.); *In re Ann Arbor Brewing Co.*, 110 F. Supp. 111, 115–116 (E.D. Mich.).[1] This line of authority is correct. Section 70c is intended to enable a trustee readily to marshal the assets of the estate, not to avoid a concededly valid tax lien against the bankrupt through invocation of a recording statute designed primarily to protect certain third parties without notice. The Court recently denied certiorari where the identical question was presented (*Borough of East Newark* v. *United States*, 364 U.S. 828). There is no greater reason for review of this issue in the present case.

Respectfully submitted.

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Attorneys.

MAY 1961.

[1] Prior to *Gilbert Associates*, the Second Circuit, although giving the federal tax lien priority over the trustee's claim on another ground, had ruled that a trustee in bankruptcy was a "judgment creditor" under Section 3672 of the 1939 Code. *United States* v. *Sands*, 174 F. 2d 384, 385. Subsequent to *Gilbert Associates*, and in reliance thereon, the Second Circuit reached the contrary conclusion in *Brust* v. *Stutz*, *supra*, p. 126, and in effect overruled its *Sands* decision.

No. 83

In the
Supreme Court of the United States

OCTOBER TERM, 1961

HATTIEBELLE O. SIMONSON, Trustee in Bankruptcy of the Estate of Max L. Druxman, Bankrupt, *Petitioner*,
vs.
R. C. GRANQUIST, District Director of the Internal Revenue Service, *Respondent*.

and

RICHARD D. HARRIS, Trustee for Alaska Telephone Corporation, *Petitioner*,
vs.
UNITED STATES OF AMERICA, *Respondent*,

UPON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF PETITIONERS

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In the

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No. 83

UPON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF OF PETITIONERS

OPINIONS BELOW

A. *Simonson v. Granquist:*

The Referee's Findings, Conclusions and Order and the Order of the District Court for the District of Oregon, are unreported, but are fully set forth in the Transcript of Record (S.R. 7, 22 and 27). All references to the *Simonson* record are herein denoted as "S.R." The opinion of the United States Court of Appeals for the Ninth Circuit (S.R. 34-37) is reported at 287 F.2d 489.

B. *Harris v. United States of America:*

The Referee's Opinion, Findings of Fact, Conclusions of Law, and Orders, as entered by the District Court for the Western District of Washington, are unreport-

ed, but are fully set forth in the Transcript of Record (H.R. 33-46, 54-57). All references to the *Harris* record are herein denoted as "H.R." The opinion of the United States Court of Appeals for the Ninth Circuit (H.R. 65-66) is reported at 287 F.2d 491.

JURISDICTION

In both cases, the judgment of the court of appeals was entered on February 1, 1961 (S.R. 37; H.R. 66). A petition for rehearing was denied on March 13, 1961, (H.R. 67). The petition for writ of certiorari was filed on April 22, 1961, and was granted on June 5, 1961 (H.R. 67). 6 L. Ed.2d 854. The jurisdiction of this Court rests upon 28 U.S.C. §1254(1) and 11 U.S.C. §47.

QUESTIONS PRESENTED

A. In *Simonson v. Granquist* and *Harris v. United States of America*:

Is an addition to a federal tax imposed as a penalty by statute, and which became a secured claim against the property of the taxpayer and for which a lien arose and notices of lien were filed prior to the filing of a petition in bankruptcy or reorganization, properly allowable as a secured claim against the debtor's estate, or is such claim disallowed by the operation of Section 57(j) of the Bankruptcy Act?

B. In *Simonson v. Granquist* alone:

Is the trustee in bankruptcy a "judgment creditor" within the purview of Section 6323(a) of the Internal Revenue Code of 1954 so that the United States does not have a valid tax lien as against the trustee in bank-

ruptcy where its tax assessments and the demand for payment were made prior to the filing of the petition in bankruptcy, but notice of the tax lien was not filed until after the petition in bankruptcy had been filed?

STATUTES INVOLVED

A. In *Simonson v. Granquist* and *Harris v. United States of America*:

Sections 17. 57(j) and 67(b) of the Bankruptcy Act (11 U.S.C. §35, 93(j) and 107(b)) are involved, as is Section 6321 of the Internal Revenue Code of 1954 (26 U.S.C. §6321). These are set forth in the appendix, *infra*, pp. 27, 28, 31.

B. In *Simonson v. Granquist* alone:

Sections 64(a) and 70(c) of the Bankruptcy Act (11 U.S.C. §§104(a) and 110(c)) are involved, as is Section 6323 of the Internal Revenue Code of 1954 (26 U.S.C. §6323). These are set forth in the appendix, *infra*, pp. 28, 31, 32.

STATEMENT OF THE CASES

A. *Simonson v. Granquist*:

Upon the trustee's application, the referee ruled upon the allowance of certain secured claims of the United States for penalties and post-bankruptcy interest. The facts are not in dispute and, as found by the referee, may be stated as follows (S.R. 7-8):

The bankrupt was in the business of a small retail jeweler and the trustee was able to realize more than $8,000 upon liquidation of the business assets. This sum was sufficient to pay all tax claims and expenses of administration (S.R. 7).

The Director of Internal Revenue filed various claims in the bankruptcy proceedings for income, employment and excise taxes accruing prior to bankruptcy and owing by the bankrupt. The trustee paid $4,932.41 of taxes owing but disputed liability for $1,442.41 of penalties and $182.49 of post-bankruptcy interest (S.R. 6-8).

The taxes and penalties involved were assessed against Druxman on September 6, 1957, and a statement of tax due and demand for payment was issued ten days later. Druxman filed a voluntary petition in bankruptcy on October 18, 1957. The notice of tax lien was filed by the District Director of Internal Revenue on October 31, 1957 (S.R. 7).

The United States asserted its claim for taxes, penalties and interest as a secured creditor by virtue of its pre-existing lien and not as a priority unsecured creditor (S.R. 8).

The referee held that the federal tax lien was perfected against the trustee where the tax had been assessed and demand for payment had been made upon the taxpayer prior to bankruptcy although notice of the lien was not filed until after the filing of the petition in bankruptcy (S.R. 9-11). The referee also held that Section 57(j) of the Bankruptcy Act applies only to unsecured claims and does not disallow the payment of penalties on a tax lien (S.R. 11-13). Finally, the referee held that the United States was not entitled to post-bankruptcy interest (S.R. 13-21).

The trustee petitioned the district court for review of the referee's order insofar as it allowed the United

States penalties included in its claim based on a federal tax lien (S.R. 28-29). The district court affirmed the order of the referee (S.R. 27-28). The trustee then appealed to the United States Court of Appeals for the Ninth Circuit, which court affirmed the order of the district court (S.R. 34-37). Petitioner then petitioned this court for certiorari, which was granted on June 5, 1961 (S.R. 67).

B. *Harris v. United States of America:*

The Alaska Telephone Corporation, the taxpayer and debtor herein, filed a petition for a reorganization under Chapter X of the Bankruptcy Act, as amended, as of September 30, 1955. The filing of this petition was approved by the district court on November 21, 1955 (H.R. 33-34).

The United States filed proofs of claims for unpaid taxes with the trustee. Included in its claims are unpaid F.I.C.A. and telephone and telegraph excise taxes for 1952 and 1953 in the amount of $56,382.93, pre-petition interest in the amount of $1,056.28, post-petition interest, and penalties imposed on such unpaid taxes in the amount of $7,714.72, for which the United States obtained liens in 1953 and filed notices of its liens in 1953 and 1954, prior to the time the debtor filed its petition in reorganization. Also, included in its claims are $182.86 of unpaid federal unemployment taxes for which a lien did not arise until 1956 and for which the United States did not seek to obtain interest or penalties (H.R. 13-20, 39-40).

Prior to the filing of the petition in reorganization

the taxpayer submitted an offer in compromise of $40,000 to settle the taxes involved and deposited that amount with the District Director of Internal Revenue between June 7, 1954, and August 19, 1955. Upon the filing of the petition for a reorganization the offer was withdrawn and the money was returned to the trustee on January 17, 1956 (H.R. 40).

A plan of reorganization was filed which, as amended, was submitted to the district court for approval which provided, among other things, for payment of $57,000 in full settlement of the debtor's federal tax liabilities (H.R. 23-29, 38). The sum $57,000 has been paid by the trustee to the District Director and is being held in a suspense account pending the outcome of these proceedings (H.R. 40). Notice was served upon the Secretary of the Treasury to accept or reject the amended plan (H.R. 32-33), and on December 26, 1958, the Acting Secretary of the Treasury, Julian A. Baird, filed a notice of rejection of the trustee's plan of reorganization with the clerk of the district court.

Following the happening of the above-mentioned matters the trustee filed objections to the claims of the United States (H.R. 13-20), which objections were heard before the referee in bankruptcy who was also designated as a special master. The referee held that the Secretary of the Treasury failed to reject properly the proposed plan of reorganization and therefore was conclusively presumed to have accepted it, and that the claims of the United States were fully satisfied by payment of the $57,000. The referee also held that the trustee was entitled to a credit against the claim of the

United States for interest in the amount of $3,863.81 on the $40,000 deposited by the debtor under the offer in compromise. Finally, the referee held that the United States was not entitled to obtain assessed or other pre-petition or post-petition interest or penalties on its secured claims (H.R. 34-37, 40, 41-45, 46).

Upon a petition for review filed by the United States (H.R. 4-10, 47-53), the district court modified the order of the referee and held that the United States had properly rejected the amended plan of reorganization, that the claims of the United States should not be reduced for interest in moneys held by it pursuant to an offer in compromise, and that the United States was entitled to pre-petition interest on the principal of all taxes owed by the debtor. However, the district court affirmed the order of the referee insofar as it disallowed the recovery of penalties and post-petition interest on the secured claims of the United States (H.R. 55-57). The United States of America then appealed to the United States Court of Appeals for the Ninth Circuit on the issue of penalties but not on the issue of post-petition interest. The circuit court reversed and remanded the order of the district court (H.R. 65-66). Petitioner then petitioned this Court for certiorari, which was granted on June 5, 1961 (H.R. 67).

SUMMARY OF ARGUMENT

I. Applicable to *Simonson v. Granquist* and *Harris v. United States of America*.

The specific provisions of Section 57(j) of the Bankruptcy Act prohibit the allowance of tax penalties in bankruptcy proceedings, and this prohibition applies

to liened as well as unliened penalties. This is so because by all applicable rules of statutory construction, the general lien allowances of Section 67(b) of the Bankruptcy Act must be read in light of and so as to give full effect to Section 57(j). Also, it is clear that the court of bankruptcy has jurisdiction to go behind general tax liens to determine which portion thereof consists of a forbidden penalty, and that not to do so is to fail to give full force to Section 57(j), thus contradicting the policy of the Bankruptcy Act by shifting the burden of the tax penalty from the bankrupt to the unsecured general creditors. This shift is particularly inequitable since Section 17 of the Bankruptcy Act operates to prevent discharge of the tax penalty in bankruptcy so that the Government penalty claim continues to exist until actually paid. Thus the holding of the Circuit Court of Appeals that a liened penalty claim is not subject to the policy of Section 57(j) is error and should be overruled.

II. Applicable to *Simonson v. Granquist* alone:

The plain language of Section 70(c) of the Bankruptcy Act gives the trustee in bankruptcy the status of a judgment creditor, and Section 6323(a) of the Internal Revenue Code of 1954 provides that a tax lien "shall not be valid as against any . . . judgment creditor until notice thereof has been filed . . ." Holdings of various circuit courts that a trustee in bankruptcy cannot claim his judgment creditor status *vis a vis* unrecorded federal tax liens are inconsistent with basic rules of statutory construction, and undercut the consistent pattern of the Bankruptcy Act and the clearly

expressed Congregessional intent behind Section 70(c). Also, the effect of these holdings is to deprive employees of the bankrupt, and those who have attempted to protect the property of the bankrupt, of the priorities expressly given them over such unrecorded federal tax liens by Section 64(a) of the Bankruptcy Act.

ARGUMENT

I. Applicable to both *Simonson v. Granquist* and *Harris v. United States of America:*

The specific provisions of Section 57(j) of the Bankruptcy Act prohibit the allowance of tax penalties in bankruptcy proceedings, and this prohibition applies to liened as well as to unliened penalties.

Section 57(j) of the Bankruptcy Act expressly forbids the assertion of penalties in a bankruptcy proceeding:

> "Debts owing to the United States or to any state or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law."

It is perfectly clear that such penalties cannot be asserted if no valid lien therefor has been established. 3 Collier on Bankruptcy (14th Ed., 1956) 301. *New York v. Jersawit,* 263 U.S. 493, 68 L.Ed. 405 (1924).

However, the government asserts, and the court of appeals in the instant cases held, that 57(j) does not apply when the lien for the penalty claimed has been

filed prior to the filing of the petition in bankruptcy, because Section 67(b) gives general support to tax liens in this situation. *Simonson v. Granquist* (9th C.A., 1961) 287 F.2d 489. *Harris v. United States* (9th C.A., 1961) 287 F.2d 491. The circuit court here elected to follow, without elucidation, its earlier opinion in *In re Knox-Powell-Stockton Co.* (9th C.A., 1939) 100 F2d 979. Two other circuits have made similar rulings. *United States v. Mighell* (10th C.A., 1959) 273 F.2d 682; *Grimland v. United States* (10th C.A., 1953) 206 F.2d 599; *Commonwealth of Kentucky ex rel. Unemployment Compensation Commission v. Farmers Bank and Trust Co.* (6th C.A., 1943) 139 F.2d 266.

However, in another line of recent circuit court decisions, the courts refused to stop their analysis with an assertion of an alleged conflict between Sections 67(b) and 57(j), and in well-reasoned opinions demonstrated that 67(b) must be read in light of the specific prohibitions of 57(j).

> "Sec. 67, sub. b merely exempts certain statutory liens, including tax liens, from the provisions concerning preferences in Sec. 60. Nothing in the language of Sec. 67, sub. b justifies the conclusion that it is intended to except liened penalties from the prohibition of Sec. 57, sub. j. Both sections are entitled to be given effect." *United States v. Harrington* (4th C.A., 1959) 269 F.2d 719.

See also *United States v. Phillips* (5th C.A., 1959) 267 F.2d 374. And see *In re Burch* (D.C. Kan., 1948) 89 F. Supp. 249; *In re Hankey Baking Co.* (D.C. W.D. Pa., 1959) 125 F.Supp. 673; *In re Lykens Hosiery Mills, Inc.*, (D.C. S.D. N.Y., 1956) 141 F.Supp. 895; *In re*

Parchem (D.C. Minn., 1958) 166 F.Supp. 724. The *Phillips* court quoted with approval the dissent of Judge Simon from the decision in *Commonwealth of Kentucky, supra*:

> "I agree with the opinion of the majority that the exaction imposed by Kentucky law for failure to pay past-due unemployment contributions constitutes a penalty. I am unable to agree that [57(j)] does not come into operation because the Bankruptcy Act preserves liens valid under state law, and this with all due respect for the views of my associates and the opinion of the Circuit Court of Appeals for the Ninth Circuit in the Knox-Powell-Stockton Co. case.
>
> "A lien is a charge upon property for the payment or discharge of a debt. It is therefore dependent upon the existence, the amount of, and the provability of the debt. If the debt has been paid or otherwise expunged as for fraud or by set-off, the lien is extinguished. An inchoate lien does not ripen into security until a debt comes into existence. In the case of private liens, it may be impermissible to prove a debt because of the statute of frauds or the running of the statute of limitations.
>
> "* * * I am unable to see how a lien, however valid it may be under state law, will breathe life into an unprovable debt in the face of [57(j)] which deals expressly with debts owing to any state or subdivision. The two provisions of the Bankruptcy Act are not irreconcilable. The tax lien is preserved to the extent that it does not include a penalty and the tax debt, other than the amount of the penalty, is provable. To the extent that the debt is not provable in bankruptcy, the lien ceases for all practical purposes to exist * * *." 139 F.2d 267.

1. *The specific prohibition of Section 57(j) applies because by all rules of statutory construction the general lien allowances of Section 67(b) must be read in light of and so as to give full effect to Section 57(j).*

This reading of the specific disallowance of Section 57(j) as being consistent with the more general protective provision of Section 67(b) is consonant with the basic principles of statutory construction. Where possible, it is the duty of the courts, in the construction of statutes, to adopt the construction of a statutory provision which harmonizes and reconciles it with other statutory provisions. 50 Am. Jur. 367, Statutes § 363, and footnote 12 where extensive case authority is cited. Specific terms covering a single subject matter will prevail over general language which otherwise might be controlling, *Baltimore National Bank v. State Tax Commission,* 297 U.S. 209, 80 L.Ed. 586 (1936); *Kepner v. United States,* 195 U.S. 100, 49 L.Ed. 114 (1904); *D. Ginsberg & Sons v. Popkin,* 285 U.S. 204, 76 L.Ed. 704 (1932); *Re East River Towing Company,* 266 U.S. 355, 69 L.Ed. 324 (1924). Thus to hold that Section 57(j) applies only to unliened penalties severely limits the operation of that section, and allows the general wording of Section 67(b) to take precedence. It is much more reasonable to allow 57(j) to control whenever a penalty, liened or unliened, is attempted to be claimed.

2. *The prohibition of Section 57(j) can be applied to liened claims because it is clear that the court of bankruptcy has jurisdiction to go behind general tax liens to determine which portion thereof consists of a forbidden penalty.*

The jurisdiction of the court of bankruptcy to look behind liens, including even liens based on the judgments of other courts, is clear. *Pepper v. Litton*, 308 U.S. 295, 84 L.Ed. 281 (1939):

> "Hence this court has held that a bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful existence. *Lesser v. Gray*, 236 U.S. 70, 57 L.Ed. 471. And the mere fact that a claim has been reduced to judgment does not prevent such an inquiry. As the merger of a claim into judgment does not change its nature so far as provability is concerned, *Boyuton v. Ball*, 121 U.S. 457, 30 L.Ed. 985, so the court may look behind the judgment to determine the essential nature of the liability for purposes of proof and allowance. *Wetmore v. Markoe*, 196 U.S. 68, 49 L.Ed. 390 * * *." *Ibid*, at 305-06, 288.

Thus, although a general "lien for taxes" including penalties may be created by the provisions of Section 6321 of the Internal Revenue Code, it is clearly within the jurisdiction of the court of bankruptcy to determine whether any portion of a general lien is based on a debt forbidden to be proved. As was held in *Phillips*:

> "The statutory enactment that the amount of an unpaid tax shall be a lien is, we think, nothing but a shorthand provision creating a tax lien to secure the obligation of the unpaid tax. The penalty is an obligation of the defaulting taxpayer. The character of the obligation as a penalty is not changed, as we view the question, when it becomes a secured obligation. If the Government's claim against the bankrupt continues to be a penalty, and we think it did, and if the Government sustains no pecuniary

> loss by the act, transaction or proceeding out of which the penalty arose, and it is not so contended, then we conclude that the amount of the penalty was properly excluded from the Government's claim as allowed." *Ibid.* at 377.

This holding is perfectly consistent with the persuasive dictum of this Court in *Gardner v. New Jersey*, 329 U.S. 565, 91 L.Ed. 504 (1947):

> "The reorganization court may also adjudicate questions pertaining to the amount of a tax claim secured by a lien without crossing the forbidden line marked by *Arkansas Corporation Commission v. Thompson*, 313 U.S. 132, 85 L.Ed. 1244 (1941). There is, for example, the question whether the amount of the claim has been swollen by the inclusion of a forbidden penalty and thus to that extent does not meet the bankruptcy requirements for proof and allowance of claims. [Section 57(j)] provides that debts owing a State as a 'penalty or forfeiture' shall not be allowed." *Ibid.* at —.

3. *The prohibition of Section 57(j) should be applied because the failure to give full force thereto contravenes the policy of the Bankruptcy Act and in fact shifts the burden of the penalty from the bankrupt to the unsecured general creditors.*

The government, on the other hand, would read the explicit prohibition of Section 57(j) and the general provisions of Section 67(b) as if they had no relationship whatsoever. This is not only inconsistent with the logical construction of the Bankruptcy Act, but contravenes the policy consideration underlying Section 57(j). A penalty is still a penalty regardless of its being cloaked by a tax lien for the purpose of putting

additional weight behind the collection machinery of the Internal Revenue Service. To hold otherwise would operate unfairly to punish general creditors who contributed to the bankrupt's estate by enforcing a punishment directed at the bankrupt only and not at those dealing with him in good faith. *In re Burch* (D. Kan., 1948) 89 F.Supp. 249.

"The government collects its revenue and other claims, to an increasing extent, not from its taxpayers and those who enter into direct business relations with it or its various agencies, but from those who enter into business relations with taxpayers * * *." MacLachlan, *Improving the Law of Federal Liens and Priorities*, 1 B.C. Ind. and Com. L. Rev. 73 (1959). And see recent law review comments, all approving the results in *Phillips* and *Harrington*, based on the conclusion that to read 57(j) narrowly as the government here asks is to punish the creditors who actually contributed to the bankrupt's estate prior to bankruptcy while allowing recovery to the government of a mere fine or punishment which should be assessed against the bankrupt alone. 38 Tex. L. Rev. 800 (1960); 40 B.U. L. Rev. 136 (1960); 47 Minn. L. Rev. 1149 (1960).

4. *This effective transfer of the penalty to the unsecured general creditors is particularly inequitable because Section 17 of the Bankruptcy Act acts to prevent discharge of the penalty in bankruptcy so that the Government claim continues to exist until actually paid.*

Additional weight is given to the conclusion that the purpose of 57(j) is to avoid shifting punishment from

the bankrupt to the creditors, and that full force must be given to the section, by the provisions of Section 17 of the Bankruptcy Act (11 U.S.C. § 35):

> "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as * * * are due as a tax levied by the United States * * *.

It seems clear that, except when disallowed by such a specific section as 57(j), tax penalties will, under the language of Section 6321 of the Internal Revenue Code, be considered a part of the tax levied by the United States. Thus, while ordinary creditors' unsecured claims will be discharged in the bankruptcy action, the penalty owing the government will *not* be discharged and will still be alive and enforceable by the government after the proceedings. 1 Collier on Bankruptcy (14th Ed., 1956) §§ 17.05, 17.13. The language of *United States v. Mighell* (10th C.A., 1959) 273 F.2d 682, is expressly contra, but that was a logical result only when liened tax penalties were held provable in bankruptcy in spite of 57(j). Thus not only would allowance of liened penalties be, in actual effect, a transfer of punishment from the bankrupt to the general creditors, but such transfer is unnecessary to protect the existence of the Government's claim. The Internal Revenue Service's "bird-in-the-hand" philosophy of collection should not be allowed to run so far.

> "We are reminded that legislation in aid of the collection of Government revenues should be liberally construed and applied. But we are charged with the duty to give effect to the purpose of [57(j)] which was designed to protect general

creditors against a reduction of their dividends from a bankrupt estate by reason of penalties or forfeitures owing by the bankrupt to the United States or one of the States. The judgment of the district court [disallowing liened penalties] is affirmed." *United States v. Phillips* (5th C.A., 1959) 267 F.2d 374, 378.

II. Applicable to *Simonson* v. *Granquist* alone:

The plain language of Section 70(c) of the Bankruptcy Act gives the trustee in bankruptcy the status of a judgment creditor, and Section 6323(a) of the Internal Revenue Code of 1954 provides that a tax lien "shall not be valid as against any * * * judgment creditor until notice thereof has been filed * * *."

Section 70(c) provides:

> "The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

In spite of this language, the court below, following its decision in *United States v. England* (9th C.A., 1955) 226 F.2d 205, and the holdings in other circuits in *In re Fidelity Tube Corp.* (3rd C.A., 1960) 278 F.2d

776 (cert. denied, *sub nom, Borough of East Newark v. United States*, 5 L.Ed.2d 56 (1961)), and *Brust v. Sturr* (2d C.A., 1956) 237 F.2d 135, held that a trustee in bankruptcy could not claim the status of a judgment creditor in regard to unrecorded federal tax liens under Section 6323(a) of the Internal Revenue Code of 1954.

1. *These contrary holdings are inconsistent with basic rules of statutory construction*:

The cited holdings establish, in effect, two readings of Section 70(c); the plain meaning of that section is to define the trustee as a judgment creditor, but the cases hold this not to be so in regard to inchoate tax liens. As was said by Judge Kalodner in his exhaustive and persua ive dissent to *Fidelity Tube, supra*:

> "The text writers are in accord with the view that a bankruptcy trustee is a 'judgment creditor' under Section [70(c)]: Collier on Bankruptcy (14th ed., 1958) Vol. 4, par. 70.49, pages 1710 *et seq.*; Remington on Bankruptcy, 1957 ed., Vol. 3, pages 557, 558, 559; Seligson, Creditors Rights (1957) 32 N.Y.U.L.R. 708, 31 J. of Natl. Assn. of Ref. 113." *Ibid*, at 785.
>
> "In my view, there just cannot be two varieties of a 'judgment creditor' under separate federal statutes which relate to such creditors. A 'judgment creditor' cannot be 'fish' under one federal statute and 'fowl' under another. Nor does a bankruptcy trustee have a dual personality — that of a 'judgment creditor' in one room of the federal legislative structure and a total absence of it in another room of the same structure." *Ibid*, at 782.

Judge Hastie joined Judge Kalodner in this dissent.

Also, in a concurrence below in *Simonson*, 287 F.2d 489, 490-91, Judge Hamley expressed agreement with Judge Kalodner's dissent and stated that if it had been a matter of first impression in the Ninth Circuit, he would have held the trustee here to be a judgment creditor.

It is fundamental that "(w)here the language of a statute is plain and unambiguous and conveys a clear and definite meaning, there is no occasion for resorting to rules of statutory interpretation, and the court has no right to look for or impose another meaning." 50 Am. Jur. 205-206. Thus in the *England-Fidelity Tube* line of cases the courts have allowed their unselective anxiety to protect federal revenue sources (see *infra.*) to override the clear meaning of Section 70(c) when read in conjunction with Section 6323(a) of the Internal Revenue Code.

2. *These holdings undercut the consistent pattern of the Bankruptcy Act and the clearly expressed Congressional intent behind Section 70(c).*

The decision of this Court upon which the circuit courts relied in reaching their decisions in *Fidelity Tube* and *England, supra*, was *United States v. Gilbert Associates*, 345 U.S. 361, 97 L.Ed. 1071 (1953). That case involved the question of whether a New Hampshire city which had made a tax assessment, declared by state statutory fiat to be in the nature of a judgment, was a judgment creditor *vis á vis* federal tax liens under what is now Section 6323(a) of the Internal Revenue Code of 1954. The Court held:

> "In this circumstance, we think Congress used the word 'judgment creditor' in Section [6323(a)]

> in the usual conventional sense of a judgment of a court of record, since all states have such courts." *Ibid*, at 364.

However, *Gilbert* clearly did not concern the Bankruptcy Act. In fact, while holding the above language binding, the Court in *Fidelity Tube, supra,* virtually distinguished *Gilbert*:

> "The trustee in the instant case argues that the Supreme Court's decision in *Gilbert* was motivated by a desire to procure uniformity among the States in determining questions relating to priority of payment of lien claims and that the Supreme Court ruled as it did because it feared that if each State was left free to designate who was or who was not a 'judgment creditor' under their respective laws there would be lack of uniformity. The trustee contends that under [70(c)] there is no danger of heterogeneity since we are construing federal and not State law and that therefore the *Gilbert* decision is not apposite." *Ibid,* at 781.

Thus this Court now has an opportunity to establish a consistent *federal* pattern, and the concern for State uniformity which underlay the *Gilbert* case is not applicable.

"By its very nature and the method by which it arises, the lien is secret, as to persons dealing with the delinquent taxpayer, and these persons can do nothing to inform themselves of the lien's existence." Note, *The Rights of a Trustee in Bankruptcy as Against a Federal Tax Lien,* 35 Indiana Law Journal 351, 352. The intent of Congress to give the widest possible powers to the trustee in regard to such secret liens under

Section 70(c) is made clear in the legislative history of the section:

> "Thus the evil of secret liens has continued. It is this evil and the injustice worked upon creditors who rely upon the debtor's apparent ownership against which the law has set its face. The proposed amendment, whilst correcting the defect named, at the same time carefully guards the rights of all parties. It is evident that in the proposed amendment attempt is made to give effect to two ideas quite distinct: First, that as to the property in the custody of the bankruptcy court the bankruptcy trustee shall be considered to have the same title that a creditor holding an execution or other lien by legal or equitable proceedings levied upon that property would have under state law; and second, that as to property not in the custody of the bankruptcy court the trustee should stand in the position of a judgment creditor holding an execution returned unsatisfied, thus entitling him to proceed precisely as an individual creditor might have done to subject assets. In this way, in effect, proceedings in bankruptcy will give to creditors all the rights creditors under state law might have had had there been no bankruptcy and from which they are debarred by the bankruptcy—certainly a very desirable and eminently fair position to be granted to the trustee." Sen. Rep. No. 691, Senate Judiciary Committee, 61st Cong., 2nd Sess. (1910).

> "Traditionally, it is the primary office of the Bankruptcy Act to protect creditors, both secured and unsecured; to marshal the bankrupt's assets; and to distribute them among his creditors equitably and ratably, in accordance with their respective rights and interest.

"It follows from these broad general principles, as well as from the basic provisions of the Bankruptcy Act itself, that—

"(A) a trustee in bankruptcy occupies the position of a 'universal' judgment or lien creditor, with all such a creditor's remedies * * *." H.R. Rep. No. 1293, 71st Cong. 1st Sess. 4 (1949), in connection with the 1950 amendment to Section 70(c).

"(5) * * * Section 2 is the amendment to Section 70(c) of the act above referred to, which has been placed in the bill for the protection of trustees in bankruptcy as correlative to the amendment to Section 60, and also to simplify, and to some extent expand, the general expression of the rights of trustees in bankruptcy." *Ibid,* "Committee Amendment."

Thus it is equally clear that Congress has attempted to expand rather than diminish this power:

"The act was intended to set up a particular scheme of distribution not to be varied by exceptions found outside the act, since to do so would interfere with a well ordered and efficient working act. * * * The Bankruptcy Act has its own schedule of priorities intended to cover all situations within its terms and jurisdiction." *United States v. Sampsell* (9th C.A., 1946) 153 F.2d 731, 735.

Thus, relying on the inapposite authority of the *Gilbert* case, the circuit courts have countermanded the clear purpose of Congress in Section 70(c) and given an extraordinary protected preference to unrecorded federal tax liens.

3. *The effect of the holdings of the circuit court is to deprive employees of the bankrupt and those who attempt to protect the property of the bankrupt's estate of the priority expressly given them over unrecorded federal tax liens by Section 64(a) of the Bankruptcy Act*:

Considering the growing number of bankruptcies filed in the United States—over 25% more in 1958 than in 1932, at the depth of the Depression, 32 J. Natl. Assn. of Ref. 124 (1958) — and the fact that in only about 15% of those cases have assets remained after outstanding liens were paid, Annual Reports of the Director of the Administrative Office of the United States Courts, 1946-1957, the protective priorities established in the Bankruptcy Act assume particular significance. The main beneficiaries of the priorities established in Section 64(a) of the Act are those who act to preserve and administer the estate, and most classes of wage claimants. If the trustee cannot prevail over the unrecorded federal tax liens, the chance of these protected creditors recovering anything from the estate is greatly lessened.

This point was cogently argued in a note on *Fidelity Tube* appearing in 35 Indiana Law Journal 351 (1960) (footnotes omitted):

> "The reason the courts usually give for favoring the government is to protect the government revenues. But this policy of protecting the government revenues has not always been so overriding as to outweigh all the equities on the other side. Both Congress and the Supreme Court have allowed the policy to fall by the wayside in actions brought under the Tort Claims Act. The court has said that

when the government is made to stand the loss, the resulting burden on each taxpayer is relatively slight, but when the entire burden falls on the injured party, it may leave him destitute. As a policy matter, analogous reasoning may be applied in bankruptcy cases, and the courts could allow the trustee his status as a judgment creditor even under Section 6323 of the Code. In addition to being more just and equitable, such a result would probably be more in harmony with the over-all policy of the Code and the Bankruptcy Act. If recording is an effective means for warning other creditors of secret liens, * * * the courts should not allow the government to continue luring other creditors into a trap by adhering to the policy of protecting government revenues when recording machinery has been provided whereby notice of the secret lien can be given to the world. The court should simply interpret the language of both the Bankruptcy Act and the Internal Revenue Code according to their plain meaning and hold the trustee to be a judgment creditor within the meaning of Section 6323. Congress has provided protection for four classes of creditors, but court construction has unduly narrowed these classes. If the government lien is secret, it is secret as to anybody dealing with the bankrupt, and since congress has protected judgment creditors from secret liens, the trustee should be allowed his rights under the Bankruptcy Act in order to better accomplish the bankruptcy policy of equitable distribution. In addition to examining the general policy of the two acts, we must also look at the problem from the point of view of the policy of specific provisions of the Bankruptcy Act. The reason for the Section 64(a) priorities is to encourage efficient adminis-

tration. The *Fidelity Tube* decision does just the opposite.

"Also, the government's favored position can cause considerable hardship to others, *e.g.*, attorneys and employees. Congress has sought to insure active and efficient administration of bankrupt estates by allowing the attorney to collect his fee under the first priority of Section 64(a). But as was shown earlier many cases are no asset cases. The attorney is less likely to put forth his best efforts, if he accepts the case at all, when there are tax liens outstanding. He can usually be confident that the lien will prevail, and his chances of recovery for his services are diminished. The plight of employees of the bankrupt is even sadder than that of attorneys. Generally they will not quit their jobs before bankruptcy because of sociological and economic reasons. Thus they are almost forced to sink or swim with the bankrupt. Congress has recognized this plight by granting them a second priority under Section 64(a). The wage earners' needs are usually much more serious and more immediate than those of the government. The analogy to the Tort Claims case is especially cogent in this area, and the court should give relief by applying the plain meaning rule in interpreting the Bankruptcy Act and the Code."

Thus this Court, which has never squarely held on this point, should take this opportunity to clarify the status of the trustee in bankruptcy as a judgment creditor. The only situation in which the government could possibly suffer loss under such a holding is when it fails to protect itself by using the simple machinery of recording its tax lien.

CONCLUSION

For the reasons stated, it is respectfully suggested that the Court of Appeals erred, that liened tax penalties should be held to come under the ban of Section 57(j) of the Bankruptcy Act, and that the language of Section 70(c) of the Bankruptcy Act should be held to give the trustee the status of a judgment creditor for purposes of Section 6323(a) of the Internal Revenue Code of 1954.

Respectfully submitted,

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APPENDIX

FEDERAL STATUTES INVOLVED

Bankruptcy Act

Bankruptcy Act § 17; 11 U.S.C. §35: Debts not affected by a discharge:

A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality; (2) are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive, or for willful and malicious injuries to the person or property of another, or for alimony due or to become due, or for maintenance or support of wife or child, or for seduction of an unmarried female, or for breach of promise of marriage accompanied by seduction, or for criminal conversion; (3) have not been duly scheduled in time for proof and allowance, with the name of the creditor if known to the bankrupt, unless such creditor had notice or actual knowledge of the proceedings in bankruptcy; (4) were created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer or in any fiduciary capacity; (5) are for wages which have been earned within three months before the date of commencement of the proceedings in bankruptcy due to workmen, servants, clerks, or traveling or city salesmen, on salary or commission basis, whole or part time, whether or not selling exclusively for

the bankrupt; or (6) are due for moneys of an employee received or retained by his employer to secure the faithful performance by such employee of the terms of a contract of employment. As amended July 12, 1960, Pub. L. 86—621; § 2, 74 Stat. 409.

Bankruptcy Act §57(j); 11 U.S.C. § 93(j) Proof and allowance of claims:

* * *

Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.

* * *

Bankruptcy Act §64(a); 11 U.S.C. § 104(a): Debts which have priority:

The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary and expense fund; the filing fees paid by creditors in involuntary cases or by persons other than the bankrupts in voluntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the

bankrupt's discharge or in connection with the criminal prosecution of an offense punishable under chapter 9 of Title 18, or an offense concerning the business or property of the bankrupt punishable under other laws, Federal or State; the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow: *Provided, however,* That where an order is entered in a proceeding under any chapter of this title directing that bankruptcy be proceeded with, the costs and expenses of administration incurred in the ensuing bankruptcy proceeding shall have priority in advance of payment of the unpaid costs and expenses of administration, including the allowances provided for in such chapter, incurred in the superseded proceeding and in the suspended bankruptcy proceeding, if any; (2) wages and commissions, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; and for the purposes of this clause, the term "traveling or city salesman" shall include all such salesmen, whether or not they are independent contractors selling the products or services of the bankrupt on a commissoin basis, with or without a drawing account or formal contract; (3) where the confirmation of an arrangement or wage earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the

efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under chapter 9 of Title 18, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however*, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy. As amended July 30, 1956, c. 784, § 1, 70 Stat. 725; July 28, 1959, Pub. L. 86—110, § 3, 73 Stat. 260.

Bankruptcy Act §67(b); 11 U.S.C. 107(b): Liens and fraudulent transfers:

(b) The provisions of section 96 of this title to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or to any State or any subdivision thereof, created or recognised by the laws of the United State or of any State, may be valid against the trustee, even though arising or perfected while the

debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this title by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

Bankruptcy Act § 70(c); 11 U.S.C. §110(c): Title to Property:

(3) The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

Internal Revenue Code of 1954

Internal Revenue Code of 1954 §6321; 26 U.S.C. § 6321: Lien for taxes:

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property,

whether real or personal, belonging to such person. Source: Sec. 3670, 1939 Code.

Internal Revenue Code of 1954 §6323(a), (b); 26 U.S.C. §6323(a), (b): Validity against mortgagees, pledgees, purchasers, and judgment creditors:

(a) INVALIDITY OF LIEN WITHOUT NOTICE.—Except as otherwise provided in subsection (c) the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

Source: Sec. 3672(a), 1939 Code.

(1) UNDER STATE OR TERRITORIAL LAWS.—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

Source: Sec. 3672(a)(1) (in part), 1939 Code.

(2) WITH CLERK OF DISTRICT COURT.—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

Source: Sec. 3672(a)(2) (in part), 1939 Code.

(3) WITH CLERK OF DISTRICT COURT FOR DISTRICT OF COLUMBIA.—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

Source: Sec. 3672(a)(3), 1939 Code.

[Sec. 6323(b)]

(b) FORM OF NOTICE.—If the notice filed pursuant to subsection (a) (1) is in such form as would be valid if filed with the clerk of the United States district court pursuant to subsection (a)(2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

Source: New.

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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 83

HATTIEBELLE O. SIMONSON, TRUSTEE IN BANKRUPTCY OF THE ESTATE OF MAX L. DRUXMAN, BANKRUPT, PETITIONER

v.

R. C. GRANQUIST, DISTRICT DIRECTOR OF THE INTERNAL REVENUE SERVICE

RICHARD D. HARRIS, TRUSTEE FOR ALASKA TELEPHONE CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS

OPINIONS BELOW

The opinion of the court of appeals in *Simonson* v. *Granquist* (S.R. 33–36) [1] is reported at 287 F. 2d 489. The opinion of the court of appeals in *Harris* v.

[1] "S.R." refers to the portion of the record pertaining to *Simonson* v. *Granquist;* "H.R." refers to the portion of the record pertaining to *Harris* v. *United States.*

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United States (H.R. 65–66) is reported at 287 F. 2d 491.

The referee's findings and conclusions in *Simonson* (S.R. 7–21) are not officially reported, and the district court wrote no opinion. The referee's opinion in *Harris* (H.R. 33–37) and his findings of fact and conclusions of law (H.R. 38–45) are not officially reported; the district court in *Harris* wrote no opinion, and its order adopting and modifying in part the order of the referee (H.R. 54–57) is not officially reported.

JURISDICTION

The judgment of the court of appeals in *Simonson* was entered on February 1, 1961 (S.R. 37). A petition for rehearing was filed on March 2, 1961, and was denied on March 13, 1961 (S.R. 37). The judgment of the court of appeals in *Harris* was entered on February 1, 1961 (H.R. 66). A petition for rehearing was filed on March 7, 1961, and was denied on March 13, 1961 (H.R. 67). A consolidated petition for a writ of certiorari for both cases was filed on April 22, 1961, and was granted on June 5, 1961 (H.R. 67; 366 U.S. 943). The jurisdiction of this Court is invoked under Section 24a of the Bankruptcy Act and 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. In *Simonson* v. *Granquist* and *Harris* v. *United States:*

Whether an addition to a federal tax imposed as a penalty by statute, which became a secured claim against the property of the taxpayer and for which

a lien arose prior to the filing of a petition in bankruptcy or reorganization, is properly allowable as a secured claim against the debtor's estate, or is to be disallowed under the terms of Section 57j of the Bankruptcy Act.

2. In *Simonson* v. *Granquist:*

Whether, by virtue of Section 70c of the Bankruptcy Act, a trustee in bankruptcy is a "judgment creditor" within the meaning of Section 6323(a) of the Internal Revenue Code of 1954, so that a federal tax lien is not valid against him, if notice of the lien is not filed until after bankruptcy.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and of the Bankruptcy Act, as amended, are set forth in the Appendix, *infra,* pp. 42–48.[2]

STATEMENT

Simonson v. *Granquist*

Upon liquidation of the business assets of the bankrupt, Max L. Druxman, a retail jeweler, the trustee was able to realize more than $8,000, which was suffi-

[2] The taxes and penalties in *Simonson* v. *Granquist* were imposed under the Internal Revenue Code of 1954, and the tax liens in that case arose under the 1954 Code. The taxes and penalties in *Harris* v. *United States* were imposed under the Internal Revenue Code of 1939, and the tax liens in that case arose under the 1939 Code, namely Sections 3670, 3671 and 3672. These provisions are similar to Sections 6321, 6322 and 6323 of the 1954 Code, which are set forth in the Appendix, *infra,* pp. 42–43.

cient to pay all tax claims and expenses of administration (S.R. 7).

The District Director of Internal Revenue filed various claims in the bankruptcy proceeding for income, employment and excise taxes accruing prior to bankruptcy and owed by the bankrupt. The trustee paid $4,932.41 of taxes owing but disputed liability for $1,442.41 of tax penalties (S.R. 6–8). The taxes and penalties had been assessed against Druxman on September 6, 1957. A statement of tax due and a demand for payment had been issued ten days later. Druxman filed a voluntary petition in bankruptcy on October 18, 1957. The District Director of Internal Revenue filed a notice of tax lien on October 31, 1957 (S.R. 7). The United States asserted its claim for taxes and penalties as a secured creditor by virtue of its pre-existing lien and not as an unsecured creditor with priority (S.R. 8). The trustee paid only the principal amount of the taxes claimed (S.R. 7).

The referee held that the federal tax lien had been perfected against the trustee when the tax had been assessed and the demand for payment had been made upon the taxpayer prior to bankruptcy, even though notice of the lien was not filed until after the filing of the petition in bankruptcy (S.R. 9–11). The referee also held that Section 57j of the Bankruptcy Act applied only to unsecured claims and did not apply to disallow the payment of assessed penalties on a tax lien (S.R. 11–13).

Upon the trustee's petition for review (S.R. 28–29), the district court affirmed the order of the referee

(S.R. 27–28), and the court of appeals affirmed the order of the district court (S.R. 33–36).

Harris v. *United States*

A petition for a reorganization under Chapter X of the Bankruptcy Act, as amended, was filed as of September 30, 1955,[3] by the taxpayer and debtor, the Alaska Telephone Corporation, and was approved by the district court on November 21, 1955 (H.R. 33–34).

The United States filed proofs of claims for unpaid taxes with the trustee. Included in its claims, insofar as relevant to this proceeding, were unpaid Federal Insurance Contributions Act taxes and telephone and telegraph excise taxes for 1952 and 1953 in the amount of $56,382.93, pre-petition interest in the amount of $1,056.28, and penalties imposed on such unpaid taxes in the amount of $7,714.72, for a total amount of $65,153.93. The United States had obtained liens for these claims in 1953 and had filed notices of its liens in 1953 and 1954 before the debtor filed its petition in reorganization. (H.R. 13–20, 39–40.)[4]

A plan of reorganization was filed which, as amended, was submitted to the district court for ap-

[3] Initially this petition was filed on September 30, 1955, under Chapter XI of the Bankruptcy Act relating to proceedings in arrangements but was subsequently amended to bring the proceedings under Chapter X dealing with corporate reorganizations (H.R. 30).

[4] The United States also filed a claim for $182.86 of unpaid federal unemployment taxes for which a lien did not arise until 1956 and for which the United States did not seek to obtain interest or penalties.

proval, and which provided, among other things, for the payment of $57,000 in full settlement of the debtor's federal tax liabilities (H.R. 23–29, 38).* The trustee served notice upon the Secretary of the Treasury to accept or reject the amended plan (H.R. 32–33), and on December 26, 1958, the Acting Secretary of the Treasury, Julian A. Baird, filed a notice of rejection of the trustee's plan of reorganization with the clerk of the district court (H.R. 34–35).

Subsequently, the trustee filed objections to the claims of the United States (H.R. 13–20), which objections were heard before the referee in bankruptcy who was also designated as a special master. The referee held that the Secretary of the Treasury had failed to reject properly the proposed plan of reorganization and that therefore he must be conclusively presumed to have accepted it. The referee also held that the claims of the United States were fully satisfied by payment of the $57,000, and that the United States was not entitled to obtain assessed or other prepetition interest or penalities on its secured claims. (H.R. 34–37, 40, 41–45, 46.)

Upon a petition for review filed by the United States (H.R. 4–10, 47–53), the district court modified the order of the referee and held that the United States had properly rejected the amended plan of reorganization and that the United States was entitled to prepetition interest on the principal of all taxes owed by

* The $57,000 has been paid by the trustee to the District Director and is being held in a suspense account pending the outcome of these proceedings (H.R. 40).

the debtor. But the district court affirmed the order of the referee insofar as it disallowed the recovery of penalties on the secured claims of the United States (H.R. 55–57.) The United States appealed to the court of appeals from the disallowance of the portion of its liened claim for penalties (H.R. 58, 62–63), and the court of appeals reversed the order of the district court in this respect (H.R. 65–66).

SUMMARY OF ARGUMENT

I

Section 6321 of the Internal Revenue Code of 1954 is the statutory basis for the federal tax lien. It clearly provides that a tax penalty, as well as the tax itself, may be included as an integral part of the tax lien. Although Section 57j of the Bankruptcy Act operates to disallow all debts owing to the United States or to any of the states to the extent that the debts include penalty claims, it does not operate to disallow lien claims for penalties because that subsection, as well as all the other subsections of Section 57, is concerned with unsecured, and not secured, claims.

This conclusion accords with the structure of the Bankruptcy Act, which creates a fundamental distinction of status between secured and unsecured claims. Section 67b of the Bankruptcy Act specifically validates federal tax liens as against a trustee in bankruptcy. Under Section 67b, a lien, which is considered valid as against a bankrupt's property prior to a bankruptcy proceeding, remains valid and effec-

tive as against the trustee in bankruptcy. When property subject to a pre-existing lien passes to the trustee, it passes subject to the lien, and the trustee receives as part of the general estate only the equity in the bankrupt's estate in excess of the lien.

Although a court, under either its bankruptcy or ancillary jurisdiction, may go behind a lien and strike it down if it secures an underlying debt which is invalid under state law because it was obtained by fraud or usury, or because the statute of limitations has run, the court cannot strike down a lien which secures an underlying debt for federal tax penalties, since the debt, as well as the lien, is valid under the Internal Revenue Code. Moreover, since the lien would not be subject to Section 57j in a plenary suit brought by a trustee under the bankruptcy court's ancillary jurisdiction, it should not be considered subject to Section 57j in the bankruptcy proceedings proper, especially since in bankruptcy proceedings the lien is valid under Section 67b of the Bankruptcy Act.

The legislative history of Sections 57j and 67 also bears out the conclusion that Section 57j does not apply to a federal or state tax lien. In the early bankruptcy acts, which contained no counterpart of Section 57j, Congress specifically indicated that secured claims were to be preserved and protected, and that the rights of the United States to recover amounts due and owing were not to be impared. When Section 57j was finally enacted in 1898, Congress gave no indication that the subsection was to apply to anything other than unsecured claims. In fact, Section 67d provided that

valid liens were not to be affected by the Bankruptcy Act. Neither the 1938 Chandler Act amendments nor the 1952 amendments to the Bankruptcy Act affected the validity of federal tax liens. Moreover, although Congress amended Section 57 both in 1938 and in 1952, it failed to extend the ban of Section 57j to pre-existing tax liens. Opinions of the Sixth, Ninth, and Tenth Circuits, and of this Court in *Goggin* v. *California Labor Div.*, 336 U.S. 118, support the government's interpretation of the Bankruptcy Act.

II

Although the tax lien in *Simonson* arose and was perfected before the petition in bankruptcy was filed, notice of the lien was not filed until after the petition had been filed. The trustee argues that under Section 70c of the Bankruptcy Act he is a "judgment creditor" within the purview of Section 6323(a) of the 1954 Code, which provides that a tax lien "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor," until notice of the lien has been filed.

This court has consistently held that, in order for a creditor to qualify under Section 6323(a) as one who takes priority over the unfiled tax lien of the United States, that creditor must either be a "mortgagee, pledgee, purchaser, or judgment creditor" in the "usual, conventional sense" of the word, and that therefore, in order to qualify as a "judgment creditor," he must hold "a judgment of a court of record." *United States* v. *Gilbert Associates, Inc.*, 345 U.S. 361, 364. Clearly, by this standard, a trustee in bank-

ruptcy is not a "judgment creditor" for purposes of Section 6323(a), even though he is given the status of a hypothetical judicial lien creditor for limited purposes under Section 70c of the Bankruptcy Act.

Moreover, Section 67b of the Bankruptcy Act specifically recognizes the validity of a federal tax lien as against a trustee in bankruptcy. That section provides that, even if the federal tax lien arises but is not perfected before bankruptcy, the lien may nevertheless be valid if perfected within the time permitted by the statute creating the lien. Since notice of the lien cannot be filed until after the lien is perfected, a tax lien which arises *and* is perfected prior to the filing of the petition in bankruptcy should be valid under Section 70c as against the trustee, even though notice of the lien is not filed until after the petition in bankruptcy is filed. This conclusion is reinforced by Section 67c of the Act, which does not operate to invalidate federal and state statutory liens, even though it places certain limitations on them.

Thus, by virtue of the express provisions of Section 67 of the Bankruptcy Act and the judicial interpretation of Section 6323(a) of the 1954 Code, Section 70c must be interpreted as not according to the trustee the status of a hypothetical judgment creditor to enable him to oppose statutory liens for taxes, but only as according him that status to oppose contractual liens and liens obtained by legal and equitable proceedings which would have been void or voidable under state law by a creditor in the absence of bankruptcy.

ARGUMENT

I. When an addition to a Federal tax, imposed as a penalty by statute, is assessed and becomes a lien against the property of the taxpayer prior to bankruptcy, the penalty is properly allowable as a secured claim against the estate because Section 57j of the Bankruptcy Act, which disallows debt claims for penalties, applies only to unsecured claims

Section 6321 of the Internal Revenue Code of 1954 (App., *infra*, p. 42) provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any * * * assessable penalty * * *) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." Sections 6659 and 6671 of the 1954 Code provide that a penalty may be assessed, collected and paid in the same manner as a tax and that the penalty is as integral a part of a tax lien as the unpaid principle of an assessed tax liability.

Section 67b of the Bankruptcy Act (11 U.S.C. 107, App., *infra*, pp. 45–46) provides that "statutory liens for taxes and debts owing to the United States or to any State * * *, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act * * *." But Section 57j of the Bankruptcy Act (11 U.S.C. 93, App., *infra*, p. 44) operates to disallow "[d]ebts owing to the United States or to any State * * * as a penalty or forfeiture * * *, except for the amount of the pecuniary

loss sustained by the act * * * out of which the penalty or forfeiture arose * * *."

In the present cases, valid tax liens arose in favor of the United States prior to the filing of the petitions in bankruptcy court, and these liens included both the amount of the taxes owing and the amounts of the penalties properly assessed.* There is no dispute but that, had the claims of the United States for penalties not been secured by tax liens, Section 57j would have operated to disallow such amounts. The issue here, however, is whether the government is entitled to obtain the penalty portions of its liened tax claims out of the assets in the bankruptcy or reorganization estate by reason of the status of the United States as a secured creditor. In other words, the issue is whether Section 57j applies only to invalidate unsecured claims of the United States or of a State, as the government contends, or whether it also applies to invalidate secured claims of the United States or of a State by allowing the bankruptcy court to go behind a valid tax lien in order to disallow the penalty portion of that lien, as the petitioner-trustees contend.

A. The structure of the Bankruptcy Act indicates that Section 57j does not disallow a secured claim for tax penalties

1. One of the fundamental distinctions in bankruptcy law, dating back at least to early English prac-

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*As to the rights of the United States claiming a lien on the property of a debtor, see, *e.g.*, *Glass City Bank* v. *United States*, 326 U.S. 265, 267; *United States* v. *Bess*, 357 U.S. 51; *Michigan* v. *United States*, 317 U.S. 338; *United States* v. *City of Greenville*, 118 F. 2d 963 (C.A. 4).

tice, is the distinction of status between a secured and an unsecured claim. The early English commercial statutes were concerned primarily with protecting unsecured creditors against fraudulent debtors. Under the common law of those days, the principal remedies of an unsecured creditor were those of attachment and execution. The diligent creditor who made the first seizure was entitled to priority to the full amount of his claim over creditors making later levies. As commerce developed, however, in situations in which a debtor had more than one creditor who had contributed to the common fund, each creditor was considered to be entitled to share in what was left of the debtor's property. Accordingly, the early English bankruptcy acts provided for the seizure of the bankrupt's property by a common agent acting in behalf of the unsecured creditors and for a pro rata distribution of the proceeds among the unsecured creditors. The early bankruptcy acts made no provision for the secured creditors, however. Property subject to a security was not considered to be part of the bankrupt's estate or to come within bankruptcy proceedings, and a secured creditor was left to his common law remedies to enforce his lien. See 1 Remington, *Bankruptcy,* pp. 4–21 (4th ed.).

This distinction between the status of a secured and an unsecured claim is mirrored in the structure of the Bankruptcy Act. Whereas Sections 57, 63, and 64 of the Act (11 U.S.C. 93, 103, 104) apply generally to the proof and allowance of claims and the priority of payment among unsecured creditors, Sections 60, 67

and 70 (11 U.S.C. 96, 107, 110) relate generally to preferences and liens of secured creditors.

Although Section 64 (App., *infra*, pp. 44–45) establishes priorities among certain classes of unsecured creditors for payment out of the general assets of the bankrupt's estate, no similar provision establishes any priorities for secured creditors; rather, the order of payment to secured creditors is based upon the common law principles governing the priority of their respective liens—generally the principle of first in time, first in right.[7] Moreover, a contingent claim is not provable against the general estate under Section 63, but an existing lien for a contingent claim is valid.[8] Similarly, although unsecured rentals do not constitute a provable claim against the general estate, a lien for rentals is not affected by bankruptcy of the lessee; rather, once the trustee has converted the bankrupt's property into cash, the lien creditors are entitled to rental payments from the proceeds.[9] Furthermore, a secured creditor is not entitled to vote or

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[7] See, *e.g.*, *In re Pennsylvania Central Brewing Co.*, 114 F. 2d 1010 (C.A. 3); *DeLaney* v. *City and County of Denver*, 185 F. 2d 246, 249–250 (C.A. 10); 3 Collier, *Bankruptcy*, Sec. 64.02 (14th ed., 1956). Thus, payment of a landlord's lien is not governed by Section 64, and even though a claim for local taxes has first priority under Section 64, the landlord's lien takes precedence over the tax claim. *City of Richmond* v. *Bird*, 249 U.S. 174; see *Ingram* v. *Coos County*, 71 F. 2d 889 (C.A. 9); *In re Brannon*, 62 F. 2d 959 (C.A. 5), certiorari denied *sub nom. Ryan* v. *City of Dallas*, 289 U.S. 742.

[8] See *Security Mortgage Co.* v. *Powers*, 278 U.S. 149, 155–156.

[9] See *Martin* v. *Orgain*, 174 Fed. 772, 778–779 (C.A. 5), certiorari denied, 216 U.S. 619; *Britton v. Western Iowa Co.*, 9 F. 2d 488 (C.A. 8).

participate at creditor's meetings and is not entitled to have his claims counted with those of unsecured creditors except insofar as his claim is in excess of his security interest.[10] Nor are lienholders required to contribute to the general expenses of administration, but only to those expenses concerned with the property subject to the liens.[11]

Basic to the distinction between secured and unsecured claims in bankruptcy proceedings is the fact that an unsecured creditor, including one with a priority under Section 64, must enter a bankruptcy proceeding, and file and prove his claim under Section 57 to receive even a pro rata share of the claim. On the other hand, a secured creditor, if properly and solely in possession of the property upon which he has a lien, "may disregard the bankruptcy proceeding, decline to file a claim and rely solely upon his security * * *." *United States Nat'l Bank* v. *Chase Nat'l Bank,* 331 U.S. 28, 33. In such circumstances, the bankruptcy court has only ancillary jurisdiction to determine the validity or the amount of the lien (see Section 2a(20) of the Bankruptcy Act, 11 U.S.C. 11, App., *infra,* pp. 43–44); the trustee must bring a plenary suit for those purposes. If the lienholder were either the United States or one of the States, it would thereupon be entitled to any penalties accruing on the obligation out of the property secured by the lien, for

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[10] See Sections 56b, 57e, 59e(4) of the Bankruptcy Act (11 U.S.C. 92, 93, 95).

[11] See *Reconstruction Finance Corp.* v. *Cohen,* 179 F. 2d 773, 776–777 (C.A. 10); 6 Remington, *Bankruptcy,* Secs. 2609–2610 (5th ed., 1952).

neither Section 57j nor any other section of the Bankruptcy Act pertaining to bankruptcy proceedings proper would have any application in an ancillary suit.

If, on the other hand, the property upon which the lien attached "is within the jurisdiction of the bankruptcy court," the secured creditor "must file a secured claim * * * if he wishes to retain his secured status," because the bankruptcy court "has exclusive jurisdiction over the liquidation of the security." *United States Nat'l Bank* v. *Chase Nat'l Bank, supra,* 331 U.S. at 33–34.[12] Even in this situation, however, the secured creditor is not required to file proof of the secured claim under Section 57,[13] as does an unsecured creditor, but instead may file an intervening petition with the bankruptcy court.[14] Moreover, even if the secured creditor elects to file proof of the secured claim, the filing does not deprive him of his secured status,[15] because Section 67b of the Bankruptcy Act expressly preserves the validity of an existing lien, and a lien which is con-

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[12] A secured creditor may also "waive his security and prove his entire claim as an unsecured one * * * [or] avail himself of his security and share in the general assets as to the unsecured balance." *United States Nat'l Bank* v. *Chase Nat'l Bank, supra,* 331 U.S. at 34; see Sections 57e, g, and h of the Act (11 U.S.C. 93).

[13] *Allen* v. *See,* 196 F. 2d 608, 610 (C.A. 10); *Brans* v. *City of Dallas,* 217 F. 2d 640 (C.A. 5).

[14] See, *e.g., California State Board of Equalization* v. *Coast Radio Products,* 228 F. 2d 520, 525–526 (C.A. 9); *United States* v. *England,* 226 F. 2d 205 (C.A. 9); *DeLaney* v. *City and County of Denver, supra,* 185 F. 2d at 251–252; *Gotkin* v. *Korn,* 182 F. 2d 380, 382 (C.A.D.C.).

[15] See *Reconstruction Finance Corp.* v. *Cohen, supra,* 179 F. 2d at 776–777.

sidered valid as against the bankrupt's property prior to the bankruptcy proceeding remains valid and effective as against the trustee. Thus when property subject to a pre-existing valid lien passes to the trustee under Section 70a of the Bankruptcy Act (11 U.S.C. 110, App., *infra*, p. 47), it passes subject to the lien.[16] The trustee receives as part of the general estate only the equity in the bankrupt's estate in excess of the lien [17] and therefore takes possesion only of such property and rights to property as the bankrupt possessed as of the date of the commencement of the bankruptcy proceeding.[18]

Section 57j has no application in determining the extent of a federal or state lien and the amount of the equity in excess thereof, for that section applies only

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[16] See *Burton* v. *Smith*, 13 Pet. 464, 483; *Michigan* v. *United States*, 317 U.S. 338, 340; *United States* v. *Bess*, 357 U.S. 51, 57.

[17] See *Security Mortgage Co.* v. *Powers*, *supra*, 278 U.S. at 153; *In re Quaker City Uniform Co.*, 134 F. Supp. 596 (E.D. Pa.), reversed on other grounds, 238 F. 2d 155 (C.A. 3), certiorari denied, 352 U.S. 1030.

[18] Sections 60 and 67 of the Bankruptcy Act allow the trustee to avoid certain existing liens and therefore vest him with certain rights which are greater than those of the bankrupt. Section 60 invalidates preferences relating to contractual and judicial liens, but not preferences relating to statutory liens. Section 67a invalidates judicial liens obtained within four months before bankruptcy if the bankrupt had been insolvent. Section 67d invalidates certain fraudulent liens obtained within one year prior to bankruptcy. Section 67c(2) invalidates state statutory liens for debts on personal property not reduced to possession. None of these provisions invalidate pre-existing tax liens of the United States. See *Goggin* v. *California Labor Div.*, 336 U.S. 118, 126–127; *California State Department of Employment* v. *United States*, 210 F. 2d 242 (C.A. 9); *Rochelle* v. *City of Dallas*, 264 F. 2d 166 (C.A. 5).

to federal and state claims against the estate, *i.e.*, against the equity and other lien-free property of the bankrupt. It follows that the extent of the lien is governed by Section 67b without regard to the type of debt secured.

Any other conclusion would create discordance between the evident status of a secured creditor in possession of the property and one holding a lien upon property within the jurisdiction of the bankruptcy court. Not only is it unlikely that Congress intended this unwarranted distinction, but to draw it would encourage an unseemly race between the lien holder and the trustee to gain possession of the property of the bankrupt.

Thus, the historical difference between the right of secured creditors to retain their property interest and the rules governing distribution of the bankrupt's estate, which is preserved in the structure of the Bankruptcy Act, indicates that Section 57j should have no greater application to secured claims than any of the other subsections of Section 57, which plainly have none.[19]

2. Petitioner-trustees attempt to dispute (Pet. Br. 10, 13–14) the foregoing interpretation of Section 57j of the Act by relying on the doctrine enunciated in *Pepper* v. *Litton*, 308 U.S. 295, 305–306, that "a bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful

[19] Although Sections 57e, g, and h apply to claims of secured creditors, they only govern the unsecured portions of those claims.

existence. * * * And the mere fact that a claim has been reduced to judgment does not prevent such an inquiry." Both the Fifth Circuit in *United States* v. *Phillips*, 267 F. 2d 374, and the Fourth Circuit in *United States* v. *Harrington*, 269 F. 2d 719, followed this doctrine in invalidating the government's secured claims for tax penalties.

The government does not dispute that a court, under either its bankruptcy or ancillary jurisdiction, has full power to go behind a lien to determine the validity of the underlying debt. What the government does dispute is the standard which the court must apply in determining the validity of secured claims. A typical standard is whether the underlying debt is invalid under state law, either because the statute of limitations has run, or because of fraud or usury. This standard is embodied in Section 70c of the Bankruptcy Act (11 U.S.C. 110, App., *infra*, pp. 47–48) which accords to the trustee "the benefit of all defenses available to the bankrupt as against third persons, including statute of limitations, statute of frauds, usury, and other personal defenses." In the *Pepper* case, the court struck down the lien because both the underlying debt and the judgment lien which secured it were obtained as part of a "planned and fraudulent scheme" to defraud the sole remaining creditor of a corporation (308 U.S. at 312). But the fact that a debt for tax penalties due and owing the United States is disallowable as an unsecured claim in bankruptcy under Section 57j of the Bankruptcy Act does not make Section 57j a standard by which

a bankruptcy court may determine the validity of a secured claim for tax penalties. In a plenary suit brought by the trustee under a bankruptcy court's ancillary jurisdiction, the court would certainly never invalidate the lien for tax penalties, because the penalties as well as the lien are completely valid under Sections 6321, 6659, and 6671 of the Internal Revenue Code of 1954 (see Section 2a(20) of the Bankruptcy Act; *supra*, pp. 15–16). Similarly, the court, under its bankruptcy jurisdiction should not be able to invalidate the lien for tax penalties on the basis of Section 57j (see *supra*, pp. 16–18), especially since the lien is given express validity in bankruptcy proceedings under Section 67b of the Bankruptcy Act.

B. The legislative history of Sections 57j and 67, and the judicial interpretation of that history, support the allowance of liened claims for penalties

1. *The early bankruptcy acts.*—There was no counterpart to Section 57j in the three early bankruptcy acts. See Act of April 4, 1800, c. XIX, 2 Stat. 19;[20] Act of August 19, 1841, c. IX, 5 Stat. 440;[21] Act of March 2, 1867, c. CLXXVI, 14 Stat. 517.[22] In the early acts, Congress specifically indicated that secured claims should be preserved and protected, and that the rights of the United States to recover amounts due and owing should not be impaired. See Act of April 4, 1800, *supra*, Secs. 62, 63; Act of August 19,

[20] Repealed by Act of December 19, 1803, c. VI, 2 Stat. 248.

[21] Repealed by Act of March 3, 1843, c. LXXXII, 5 Stat. 614.

[22] Amended by Act of June 22, 1874, c. 390, 18 Stat. 178; repealed by Act of June 7, 1878, c. 160, 20 Stat. 99.

1841, *supra*, Sec. 2; Act of March 2, 1867, *supra*, Secs. 14, 20, 28.

Between 1878 and 1898, numerous bankruptcy bills were introduced in Congress. In 1892, a provision disallowing the payment of penalties was introduced, but failed to pass. H.R. 9348, 52d Cong., 1st Sess., Sec. 57j. Although the majority of the House Committee on the Judiciary made no reference to the proposed Section 57j (see H. Rep. No. 1674, 52d Cong., 1st Sess.), the minority expressed concern that the proposed section might disallow the payment of penalties which merged into a judgment (see *id.* (Part 2), pp. 13–14).

2. *The Bankruptcy Act of 1898.*—Section 57j was finally enacted as a part of the Bankruptcy Act of 1898, c. 541, 30 Stat. 544. The Committee reports contained no reference to Section 57j. See H. Rep. No. 65, 55th Cong., 2d Sess., to accompany S. 1035, 55th Cong., 1st Sess.; S. Doc. No. 294, 55th Cong., 2d Sess. Nor did Congress give any other indication that Section 57j was applicable to anything but unsecured claims. All the other subsections of Section 57 related only to the unsecured portion of claims. Moreover, Section 67d provided that "[l]iens given or accepted in good faith and not in contemplation of or in fraud upon this Act * * * shall not be affected by this Act." Under Section 67d, penalties which had become a part of a lien would not be "affected" by any other provision of the Bankruptcy Act, including the prohibition in Section 57j. This interpretation of the status of a lien under Section 67d was expressly adopted by the Ninth Circuit in *In re Knox-*

Powell-Stockton Co., 100 F. 2d 979, 983–984, in which the court stated that, although "section 57j * * * precludes the 'allowance' of a claim for penalties," the section does not come into operation "where a lien exists to support a penalty at the time of adjudication" because "adjudication in bankruptcy does not affect a valid and existing lien * * *." Accord, *Commonwealth of Kentucky* v. *Farmers Bank & Trust Co.*, 139 F. 2d 266 (C.A. 6).

3. *The Chandler Act.*—In 1938, Congress passed the Chandler Act, c. 575, 52 Stat. 840, as a revision of the Bankruptcy Act. None of the Chandler Act amendments gave any indication that Section 57j was to apply to secured claims. The amendment to Section 57n, which required the United States to prove and file its claim for taxes, applied only to unsecured claims of the United States and not to those secured by pre-existing liens. The Chandler Act's reduction in priority of tax-claim payments from first to fourth under Section 64 affected only claims which were unsecured.

The Chandler Act amendments to Section 67, in particular, the deletion of Section 67d of the Act of 1898, evidenced no intention to assimilate the status of secured tax claims to the status of unsecured tax claims. The new Section 67b preserved the validity of statutory liens, including liens for taxes and debts owing to the United States or to any State or its subdivisions. Although Section 67c (11 U.S.C. 107, App. *infra*, pp. 46–47) "postponed" the payment of valid statutory liens on personal property not accompanied by possession until the

debts for certain administrative expenses and wages specified in Section 64a (1) and (2) of the Act were paid, there was no indication that the tax lien itself, or any part of it, was to be disregarded and the taxes paid as a priority claim.

Despite the limited effect of the Chandler Act, the trustees (Pet. Br. 14) rely upon dictum in *Gardner* v. *New Jersey*, 329 U.S. 565, 580–581, to support their view of Section 57j, for the Court there stated:

> The reorganization court may also adjudicate questions pertaining to the amount of a tax claim secured by a lien without crossing the forbidden line marked by *Arkansas Corporation Commission* v. *Thompson, supra.* There is, for example, the question whether the amount of the claim has been swollen by the inclusion of a forbidden penalty and thus to that extent does not meet the bankruptcy requirements for proof and allowance of claims. Section 57j of the Bankruptcy Act provides that debts owing a State as a "penalty or forfeiture" shall not be allowed. What claims accruing before bankruptcy and sought to be proved by a State are "penalties," *New York* v. *Jersawit*, 263 U.S. 493, and what are not, *Meilink* v. *Unemployment Reserves Commission*, 314 U.S. 564, * * * are * * * questions for the reorganization court.

There is considerable question whether this language has any great significance with respect to an ordinary bankruptcy proceeding. The *Gardner* case was a railroad reorganization proceding under Section 77

of the Bankruptcy Act (11 U.S.C. 205), which vests a court and the trustee with extremely broad powers over all types of liens. The court in a regular bankruptcy proceeding has no such broad powers. See 329 U.S. at 576."

Moreover, subsequent to the *Gardner* decision, this Court decided in *Goggin* v. *California Labor Div.*, 336 U.S. 118, that the Chandler Act did nothing to invalidate statutory liens, and cited with approval the Ninth Circuit's decision in the *Knox-Powell-Stockton* case, *supra*, which had held that a pre-existing tax lien is indefeasible in bankruptcy even if it secures an under-

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" It should also be noted that no penalties were involved in *Gardner*, and that the case reached the Court solely on the issue whether the reorganization court had jurisdiction to adjudicate the state's claim for taxes and interest secured by a lien. In fact, the Court refrained from intimating any "opinion on the merits of the settlement controversy," or "any view on the amount of the tax claim which should be allowed or on the validity, character, priority, or extent of the lien asserted by New Jersey, or on the manner in which it should be satisfied in a plan for reorganization" (329 U.S. at 584). The Court went on to hold only "that the reorganization court could properly entertain all objections to the claim except those involving the valuations underlying the assessments and the validity of those assessments" (*ibid.*). Moreover, the two cases cited by the Court, *New York* v. *Jerswoit*, 263 U.S. 493, and *Meilink* v. *Unemployment Reserves Commission*, 314 U.S. 564, involved only unsecured claims. Thus Section 57j was of course applicable to that part of the unsecured claims which represented penalties. The question presented in those cases was whether the contested amounts represented interest rather than penalties.

lying debt for tax penalties. As the Court in *Goggin* stated (336 U.S. at 126–127):

> While § 67c was added to the Bankruptcy Act by the Chandler Act in 1938, we find nothing in it or in its legislative history to suggest an abandonment of * * * the general purpose of Congress to continue to safeguard interests under liens perfected before bankruptcy. * * * *In re Knox-Powell-Stockton Co.*, 100 F. 2d 979 * * *. While § 64, as amended, somewhat readjusts priorities among unsecured claims, § 67 continues to recognize the validity of liens perfected before bankruptcy as against unsecured claims. Section 67b has clarified the validity of statutory liens, including those for taxes, even though arising or perfected while the debtor is insolvent and within four months of the filing of the petition in bankruptcy. * * *

The claim of the United States in the *Goggin* case involved penalties as well as taxes, all secured by perfected liens, and the penalties were allowed as a secured claim without objection that they were not allowable under Section 57j.

4. *The 1952 amendments to the Bankruptcy Act.*— The decisions by the Sixth and Ninth Circuit Courts of Appeals and by this Court preceded the 1952 amendments to the Bankruptcy Act. In the Act of July 7, 1952, c. 579, 66 Stat. 420, Congress specifically amended Sections 57j, 67b and 67c but, despite the judicial decisions, it did not extend the ban of Sec-

tion 57j to perfected tax liens.[24] It is a fair inference that Congress was satisfied with the judicial interpretation; certainly Congress had no affirmative intention to make a change.[25] As the Tenth Circuit stated in *Grimland* v. *United States*, 206 F. 2d 599, 601, a case which adhered to the *Knox-Powell-Stockton* interpretation: "It may well be that Congress had

[24] The amendment to Section 57j merely substituted the words "on the amount of such loss" for the word "thereon" to express more clearly how much interest was allowable. The amendment to Section 67b merely employed a revised definition of the petition filed in bankruptcy. The amendment to Section 67c introduced subsection (2) which deprived certain state and local statutory liens for debts on personal property not reduced to possession of their secured status. But this provision did not affect the validity of liens for taxes, whether imposed by the federal, state or local government.

[25] There have been several recent attempts to provide by legislation that, where a penalty not allowable under Section 57j is secured by a lien, the portion of the lien securing such penalty shall be disallowed. In H.R. 5195, 85th Cong., 1st Sess., and in H.R. 4158, 86th Cong., 1st Sess., the proposed amendments were made to Section 67c, whereas in H.R. 6787, 85th Cong., 1st Sess., Section 57j specifically was made applicable to debts whether or not secured by a lien. None of these proposed amendments were reported out of the House Committee on the Judiciary. In H.R. 7242, 86th Cong., 1st Sess., Sec. 6, it was proposed to amend Section 57j to apply to penalties, "whether or not secured by a lien." This bill passed the Congress in August 1960 (106 Cong. Rec. 17591), but was vetoed by the President on September 8, 1960 (106 Cong. Rec. 19168). Similar provisions are included in H.R. 1961, 87th Cong., 1st Sess., Sec. 2, which passed the House of Representatives on August 7, 1961 (107 Daily Cong. Rec. 13703), and is currently pending (October 1961) before the Senate Committee on the Judiciary. S. 1142, 87th Cong., 1st Sess., Sec. 2, the counterpart to H.R. 1961, has not been reported out by the Senate Committee on the Judiciary.

in mind that claims for tax penalties should not be allowed in bankruptcy, even though a lien has been perfected before adjudication, but the language of 57, sub. j does not adequately express that intent. We therefore hold that the claim may be enforced to the extent of the lien." Accord, *United States* v. *Mighell*, 273 F. 2d 682 (C.A. 10.)

C. Equitable considerations are not persuasive in supporting the Trustees' contention that Section 57j applies to a secured claim for tax penalties

The trustees argue (Pet. Br. 15–17) that, if the government were to be allowed to receive payment on its lien for a debt of tax penalties, the innocent unsecured creditor would be the one penalized rather than the delinquent taxpayer. But what the equities are to be between secured and unsecured creditors is a matter of policy for Congress to decide, and not the courts. As the structure and the legislative history of the Bankruptcy Act has indicated, Congress deliberately intended to grant priorities to secured creditors with valid liens at the expense of the unsecured creditors.

Congress has long favored the United States with respect to the collection of the public revenues which, by statute, may include penalties. The obligation of a bankrupt's estate to pay taxes may very well leave an unsecured creditor with empty hands. Although Congress has long been aware of the plight of the unsecured creditor and the hardships worked on him by the priority rights of secured creditors, including the United States, it nevertheless has always sought to protect the public revenue as well as to protect

secured creditors, and, in doing so, it has never seen fit to invalidate a secured tax obligation of the United States. See *Glass City Bank* v. *United States,* 326 U.S. 265, 267.

Moreover, the priority rights of a secured creditor, as well as the priority rights of the United States, claiming either as a secured or unsecured creditor, are not unique to bankruptcy. Ever since 1797, the United States has had an absolute priority for debts due from an insolvent debtor. Rev. Stat. 3466, 31 U.S.C. 191. Moreover, secured creditors consistently have received greater rights in equity receivership proceedings than in bankruptcy to the detriment of the general unsecured creditors. Thus, in a bankruptcy proceeding, a secured creditor must first exhaust his security before proving his claim for the balance on a pro-rata basis with the unsecured creditor, whereas in an equity-receivership proceeding, a secured creditor may first satisfy his claims out of the common fund while still reserving his security against any deficiency. See *Merrill* v. *National Bank of Jacksonville,* 173 U.S. 131; *United States Nat'l Bank* v. *Chase Nat'l Bank, supra,* 331 U.S. at 34.

In the present situation, Congress under Section 6321 of the 1954 Code has allowed penalties to be included in a tax lien and has provided in Section 67b of the Bankruptcy Act that the tax lien shall be valid in the bankruptcy proceedings. To now advance the contention that the penalty portion of a valid lien is to be disallowed on the ground that it is not fair to unsecured creditors, and that Congress never intended to deplete the assets available for such

unsecured creditors, is to fly in the face of the basic intention of Congress, as evidenced by the history of legislation in the tax, insolvency and bankruptcy areas, to assure the collection of the revenues of the United States.

Whenever Congress has deemed as unjust the granting of a priority to the tax obligation or any part thereof over other creditors, it has amended the law to reflect that intention, and then only to the extent of protecting certain specified groups of creditors under certain limited conditions.[26] But where Congress consistently and expressly has provided that the tax lien should be valid and has not expressly restricted the payment of any portion of the lien, there should be no basis for contending that part of the lien should be invalidated because of alleged hardships worked on lower ranking creditors.

The trustees' contention (Pet. Br. 15–17) that it would be more equitable to require the taxpayer to pay the penalties out of after-acquired assets than to

[26] Thus, the Chandler Act amended Section 57n to require the United States to file and prove its unsecured claims for debts and taxes; the Chandler Act in Section 64a reduced the priority of payment of unsecured tax claims of the United States to the fourth priority, behind claims for costs of administration, certain wage claims and specified expenses of certain creditors; the Chandler Act amended Section 67c to postpone the payment of statutory liens for taxes owing to the United States and for statutory liens for taxes owing to a state or subdivision on personal property not reduced to possession to the payment of claims for costs of administration and certain wage claims; the Act of July 7, 1952, Sec. 21(d), c. 579, 66 Stat. 420, invalidated statutory liens for debts owing to states or their subdivisions on personal property not reduced to possession.

permit collection of the penalties out of the bankruptcy estate, is immaterial,[27] for the contention would be equally applicable with respect to the principal amount of the taxes owing, as well as to other provable claims which are not affected by discharge. Nevertheless, neither the United States nor other creditors with non-dischargeable provable debts have been barred from recovering those debts out of the assets in the bankruptcy estate. Moreover, if the trustees' contention were to prevail, it would mean that the collection of the penalties would depend upon such considerations as whether the taxpayer would continue to exist after bankruptcy or reorganization, or whether it would acquire assets after bankruptcy, or whether a subsequent recovery against a reorganized debtor or a successor would or would not be barred by statute. See Section 77f (11 U.S.C. 205), relating to railroad reorganizations, and Sections 224, 226, 227, and 228 (11 U.S.C. 624, 626, 627, 628), relating to corporate reorganizations. In fact, in the *Harris* case it is very doubtful whether the United States can obtain the penalties involved except out of the estate in reorganization.

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[27] As the trustees note (Pet. Br. 16), the only decision of a court of appeals on point is *United States* v. *Mighell*, 273 F. 2d 682 (C.A. 10), which held that the United States was entitled to obtain penalties on its liened claims for taxes only to the extent of the assets in the bankruptcy estate but not out of after-acquired assets of the taxpayer. The court therefore enjoined the District Director from attempting to collect the balance of the penalties owing from after-acquired assets of the taxpayer. Cf. *Bruning* v. *United States*, 7 A.F.T.R. 2d 1431 (S.D. Calif., April 19, 1961), currently on appeal by the taxpayer in the Ninth Circuit.

II. A Federal tax lien which arises prior to the filing of a petition in bankruptcy is valid as against the trustee in bankruptcy even though notice of the lien is filed subsequent to the filing of the petition in bankruptcy because, with respect to the tax lien, the trustee is not a "judgment creditor" within the meaning of either Section 70c of the Bankruptcy Act or Section 6323(a) of the Internal Revenue Code of 1954

As an alternative argument, petitioner-trustee in *Simonson* contends that, even if Section 57j does not operate to invalidate the federal lien securing the debt for tax penalties, that lien is invalid under Section 70c of the Bankruptcy Act (11 U.S.C. 110, App., *infra,* pp. 47–48) and Section 6323(a) of the Internal Revenue Code of 1954 (App., *infra,* pp. 42–43[28] Section 70c provides that the trustee shall be deemed vested, as of the date of bankruptcy, with all the rights, remedies and powers of a judgment lien creditor, whether or not such a creditor actually exists.[29] Section 6323(a) provides that a federal tax lien "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor unless notice thereof has

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[28] Petitioner in *Simonson* does not contest the lien for the principal amount of the taxes, because he has already paid the debt on that part of the lien (S.R. 7; see the Statement, *supra,* p. 4).

[29] The pertinent language of Section 70c is as follows:
"The trustees, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien theron by such proceedings, whether or not such a creditor actually exists."

been filed * * *." In *Simonson*, although the tax lien arose before the petition in bankruptcy was filed, notice of the lien was not filed until after the petition had been filed. Petitioner-trustee in *Simonson* argues that the two sections accord him the status of a "judgment creditor" for purposes of invalidating the federal tax lien as to which notice had not been filed prior to bankruptcy. The court of appeals correctly rejected this contention.

A. Although Section 70c of the Bankruptcy Act accords to the trustee the status of a hypothetical judgment creditor, the trustee is not a "judgment creditor" within the meaning of Section 6323(a) of the Internal Revenue Code of 1954 for purposes of invalidating the Federal tax lien

1. *Judicial interpretation of Section 6323(a).*— This Court has consistently held that, in order for a creditor to qualify under Section 6323(a) of the 1954 Code, or its predecessor provision, Section 3672(a) of the 1939 Code, as one who takes priority over the unfiled tax lien of the United States, that creditor must be either a "mortgagee, pledgee, purchaser, or judgment creditor" in the "usual, conventional sense" of the word. *E.g., United States* v. *Gilbert Associates, Inc.*, 345 U.S. 361, 364. By this standard, a "judgment creditor" for purposes of Section 3672(a) is one holding a "judgment of a court of record, since all states have such courts" (*ibid.*; see *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, 52 (Jackson, J., concurring)), and a "purchaser" is "one who acquires title for a valuable consideration in the manner of vendor or vendee" (*United States* v.

Scovil, 348 U.S. 218, 221).[20] Accord, *United States* v. *Ball Construction Co.*, 355 U.S. 587 (mortgagee); *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010 (purchaser). Clearly, by this standard, a trustee in bankruptcy could not be considered a "judgment creditor" for purposes of Section 6323(a) of the 1954 Code.[21] In fact, every court of appeals which has considered the question has held that the provision in Section 70c of the Bankruptcy Act giving the trustee the status of a hypothetical judicial lien creditor does not make him a "judgment creditor" within the meaning of Section 6323(a) of the 1954 Code or its 1939 Code predecessor. *United States* v. *England*, 226 F. 2d 205 (C.A. 9); *In re Fidelity Tube Corp.*, 278

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[20] See also as to the word "purchaser", *United States* v. *Chapman*, 281 F. 2d 862, 868–869 (C.A. 10); *United States* v. *Hawkins*, 228 F. 2d 517 (C.A. 9); *New York Terminal Warehouse Co.* v. *Bullington*, 213 F. 2d 340, 344 (C.A. 5); *National Refining Co.* v. *United States*, 160 F. 2d 951, 955 (C.A. 8).

[21] Although, as the trustee in *Simonson* points out (Pet. Br. 19–20), the decisions in this Court in *Gilbert Associates* and similar cases did not directly adjudicate the rights of a trustee in bankruptcy, nevertheless the logic of those decisions is equally compelling in the present case. Similarly, although in *Gilbert Associates* concern was expressed that a particular class of creditors be treated uniformly, there is no merit to the trustee's contention (Pet. Br. 20) that there is no problem of nonuniformity in the present case. Recently, the Third Circuit in *In re Fidelity Tube Corp.*, *supra*, 278 F. 2d 776, 781, certiorari denied *sub nom. Borough of East Newark* v. *United States*, 364 U.S. 828, pointed out that, if the four protected classes of creditors listed in Section 6323(a) are to be defined one way when a debtor is solvent or when there is an insolvency or equitable receivership proceeding, but defined another way with respect to a trustee in a bankruptcy proceeding, a problem of nonuniformity will arise.

F. 2d 776 (C.A. 3), certiorari denied *sub nom. Borough of East Newark* v. *United States*, 364 U.S. 828; *Brust* v. *Sturr*, 237 F. 2d 135 (C.A. 2); *In re Taylorcraft Aviation Corp.*, 168 F. 2d 808, 810 (C.A. 6). See also *In the Matter of Green*, 124 F. Supp. 481 (N.D. Ala.); *In re Ann Arbor Brewing Co.*, 110 F. Supp. 111, 115–116 (E.D. Mich.).

2. *The legislative history of Section 6323(a).*— The meaning given by this Court to the term "judgment creditor" in Section 6323(a) is substantiated by the legislative history of the federal tax-lien statutes. Initially there was no provision in the tax-lien statute which protected a mortgagee, pledgee, purchaser, or judgment creditor from an unfiled tax lien. Rev. Stat. 3186, as amended, Act of March 1, 1879, Sec. 3, c. 125, 20 Stat. 327.[29] In 1893, this Court held in *United States* v. *Snyder*, 149 U.S. 210, that the tax lien was valid even against a bona-fide purchaser for value without knowledge or notice of the existence of the lien. To alleviate this situation, Congress further amended the tax-lien statute in 1913 to provide that the lien should not be valid as against any mortgagee, purchaser, or judgment creditor until notice of the lien had been filed. Act of March 4, 1913, c. 166, 37

[29] Prior to 1913, the language of Rev. Stat. 3186 was as follows:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment-list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person."

Stat. 1016;[9] see H. Rep. No. 1018, 62d Cong., 2d Sess., p. 2; S. Rep. No. 1315, 63d Cong., 3d Sess, p. 2. Subsequently, in 1939, Congress again amended the lien provision (then Section 3672 of the Internal Revenue Code of 1939) to extend similar protection to a "pledgee." Revenue Act of 1939, Sec. 401, c. 247, 53 Stat. 862. Thus, Congress was apparently interested in protecting as against an unfiled tax lien only certain enumerated classes of secured creditors within the conventional meaning of the terms used.

This conclusion is reinforced by the legislative history of Section 6323 of the 1954 Code. The House version of proposed Section 6323 contained a subsection (c) which provided that only a judgment creditor who actually had obtained a valid judgment in a court of record and had a perfected lien under such judgment was to be protected under Section 6323. The House Committee pointed out that subsection (c) was designed to continue by statute the rule developed by existing court decisions. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. A407 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4554–4555).

Although the Senate version of the section deleted subsection (c) of the House bill, the Senate Committee pointed out that the rule which the House bill would prescribe by statute through subsection (c) was

[9] The pertinent language added by the 1913 amendment was as follows:

"*Provided, however*, That such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the collector in the office of the clerk of the district court of the district within which the property subject to such lien is situated * * *."

unnecessary because it already existed by judicial construction, and that judicial interpretation of the existing law was preferable to a prescribed statutory rule. See S. Rep. No. 1622 to accompany H.R. 8300, 83d Cong., 2d Sess., p. 575 (3 U.S.C. Cong. & Adm. News (1954) 4621, 5224). As the Senate Committee stated (*ibid.* (emphasis added)): "*As under existing law*, a person who is *in fact* a mortgagee, pledgee, purchaser, or judgment creditor will be entitled as such to the protection of this section * * *."

In conference, the House agreed to the deletion of subsection (c) of Section 6323 of the House bill. Thus, both Houses of Congress were unanimous in accepting the rule of law established in the *Gilbert Associates* case, *supra*, and similar decisions. As the Conference Committee stated in its Report (H. Conf. Rep. No. 2543, 83d Cong., 2d Sess., p. 78 (3 U.S.C. Cong. & Adm. News (1954) 5280, 5340)):

> * * * Subsection (c) of section 6323 of the House bill provided certain specific rules with respect to the validity of the tax lien, without the filing of notice thereof, as against mortgagees, pledgees, purchasers, and judgment creditors. The Senate amendment strikes out this subsection, thereby continuing in effect the existing law, including applicable rules which have been developed by judicial construction. The House recedes.

Had Congress intended to broaden the existing rule to include a trustee in bankruptcy as a "judgment creditor" within the protection of Section 6323(a), it easily could have done so by clear and appropriate language.[44]

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[44] Legislation has recently been proposed to constitute a trustee in bankruptcy as a "judgment creditor" with respect to

3. *Equitable Considerations.*—Even if the trustee were to be considered a "judgment creditor" for purposes of Section 6323(a), the prior secured creditors would not obtain any advantage which they presently do not have under Section 6323(a). Furthermore, with respect to the claim for federal taxes itself, the requirement that notice of the tax lien be filed will not benefit the general creditors, for whom the trustee acts, because, even if the tax lien were invalidated, the principal of the federal tax would still be payable, under Section 64a(4) of the Bankruptcy Act, as a priority claim before the claims of the general creditors. Apparently, as the trustee in *Simonson* recognizes (Pet. Br. 23–25), the persons who normally benefit by an invalidation of a federal tax lien are not the general unsecured creditors, but (1) those whose claims fall within Section 64a (1)

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federal tax liens. See H.R. 7242, 86th Cong., 1st Sess., Sec. 6, which passed Congress in August 1960 (106 Cong. Rec. 17591), but was vetoed by the President on September 8, 1960 (106 Cong. Rec. 19168); H. Rep. No. 745, 86th Cong., 1st Sess., pp. 9–10; S. Rep. No. 1871, 86th Cong., 2d Sess., pp. 10–11. See also H.R. 1961, 87th Cong., 1st Sess., Sec. 7, which passed the House of Representatives on August 7, 1961 (107 Daily Cong. Rec. 13703), and is currently pending before the Senate Committee on the Judiciary; H. Rep. No. 708, 87th Cong., 1st Sess., pp. 10–12; S. 1142, 87th Cong., 1st Sess., Sec. 7, which has not been reported out by the Senate Committee on the Judiciary. The committee reports all underscore the need for Congressional action if the trustee is to be given the rights of a "judgment creditor" with respect to the federal tax lien.

Compare Section 101 of H.R. 7914, H.R. 7915, H.R. 8406 and S. 2305, 86th Cong., 1st Sess., which would have confirmed the Supreme Court's definition in *Gilbert Associates*. "To qualify for priority under this provision, a judgment must have been rendered by a court in a judicial proceeding." American Bar Association Committee on Federal Liens, *Final Report*, p. 91 (Feb. 23, 1959).

through (3) of the Bankruptcy Act, *i.e.*, claims for administration costs and expenses, limited wage claims and claims for certain extraordinary expenses of creditors; and (2) states and municipalities, which would be entitled to share as priority claimants on an equal basis with the United States, to the extent that their liens, which are junior to the federal tax lien, would be invalid in bankruptcy proceedings. It is difficult to see why these claimants should require notice of the filing of the tax lien of the United States. Certainly, Congress has not considered that these classes of creditors require protection, since Congress has not added any of these classes to the four enumerated in Section 6323(a)."

B. Although Section 70c of the Bankruptcy Act accords to the trustee the status of a hypothetical judgment creditor, Section 67 of the Act prohibits the trustee from invoking that status to invalidate a statutory lien for taxes, even though notice of the lien was filed after bankruptcy.

Further support for the conclusion that a trustee is not a "judgment creditor" under Section 6323(a) of the 1954 Code may be found in Section 67 of the Bankruptcy Act. Section 67b specifically recognizes the validity of a federal tax lien as against a trustee in bankruptcy. It provides that even if a federal or state tax lien arises but is not perfected before bankruptcy, the lien nevertheless may be valid if perfected within the time permitted by, and in accordance with, the statute creating the

"Recently legislation has been introduced to amend Section 6323 to expand the group of persons entitled to rely on a filed notice of a tax lien. See H.R. 7914, H.R. 7915, H.R. 9408, and S. 2906, 86th Cong., 1st Sess.; H.R. 4319 and H.R. 4320, 87th Cong., 1st Sess.

lien." As the draftsmen of this provision stated: "This subdivision has two purposes: first, to protect liens of the nature recited * * *; and secondly, to permit such liens to be perfected after bankruptcy, if the time allowed by law for such perfecting has not expired." Analysis of H.R. 12889, 74th Cong., 2d Sess., p. 211; see 4 Collier, *Bankruptcy*, par. 67.20, p. 183 (14th ed.).

Under Section 6323 of the 1954 Code (App., *infra*, p. 42), the tax lien imposed by Section 6321 of the 1954 Code arises at the time the assessment is made. The lien is not perfected, however, until demand for payment has been made. Nor can there be any filing of notice of the lien until after the demand for payment has been made. If, under Section 67b, a federal tax lien, which arises but is unperfected prior to bankruptcy, may be perfected after the petition for bankruptcy has been filed and still be valid as against the trustee in bankruptcy (see *Macatee, Inc.* v. *United States*, 214 F. 2d 717 (C.A. 5)), surely, a tax lien, as in the *Simonson* case, which arose and was perfected prior to the filing of the petition in bankruptcy, must be considered valid under Section 70c, as against the trustee, even though notice of the lien was not filed until after the petition in bankruptcy was filed.

Moreover, Section 67c, which imposes certain limitations on statutory tax liens, does not in any way

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"The pertinent language of Section 67b is as follows: "Where by such laws [which create the statutory liens] such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws * * *."

invalidate a federal tax lien as against the trustee. As originally enacted in 1898, the Bankruptcy Act contained no provision specifically limiting the rights of statutory lienholders to recover on their liens. Although, in 1938, the Chandler Act added provisions to govern statutory liens, none of the newly added provisions vested the trustee with the status of a judgment creditor with respect to a federal tax lien (see *supra*, pp. 22–25). Thus, the Chandler Act amended Section 67c to postpone to a limited degree the payment of stautory liens on personal property not accompanied by possession, but the amendment did not invalidate tax liens. By the Act of July 7, 1952, Sec. 21(d), c. 579, 66 Stat. 420, Section 67c was further amended to invalidate statutory liens arising under state or local law for debts on personal property not reduced to possession, but the 1952 amendment likewise did not affect the continued validity of statutory liens for taxes and debts owing to the United States or for taxes owing to a state or a subdivision.

Thus, by virtue of the express provisions of Section 67 of the Bankruptcy Act and the judicial interpretation of Section 6323(a) of the 1954 Code, Section 70c must be interpreted as not according to the trustee the status of a hypothetical judgment creditor to enable him to oppose statutory liens for taxes, but as according him that status to oppose only contractual liens and liens obtained by legal and equitable proceedings which would have been void or voidable under state law by a creditor in the absence of bankruptcy.[27]

[27] Prior to 1910, the Bankruptcy Act vested in the trustee no better right or title to the bankrupt's property than that which

CONCLUSION

For the foregoing reasons, the decision of the court of appeals (1) allowing payment of the amount of penalties included in the federal tax liens in both cases, and (2) holding that the tax lien in *Simonson* is valid as against the trustee, is correct and should be affirmed by this Court.

Respectfully submitted.

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had belonged to the bankrupt or which the bankrupt's existing creditors actually had acquired at the time the trustee's title vested. See, *e.g.*, *York Manufacturing Co.* v. *Cassell*, 201 U.S. 344, 352 (involving a state contractual lien). When Congress amended Section 47(a)(2) of the Bankruptcy Act (Act of June 25, 1910, c. 412, 36 Stat. 838, Sec. 8), which was the forerunner of Section 70c, it indicated in its committee reports that it had been concerned with the situation created by the *York* case. See S. Rep. No. 691, 61st Cong., 2d Sess., pp. 6–7; H. Rep. No. 511, 61st Cong., 2d Sess., pp. 6–7. Section 70c has been interpreted to vest the trustee with rights to invalidate only state contractual and judicial liens. See, *e.g.*, 4 Collier, *Bankruptcy*, pars. 70.47–70.48 (14th ed., 1959 rev.). In fact, when Section 70c is read in conjunction with Section 67b, which specifically preserves statutory liens, it is reasonable to conclude that Section 70c was not intended to give the trustee the right to invalidate liens created and protected by statute.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of district court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) *With clerk of district court for District of Columbia.*—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

* * * * *

(d) *Disclosure of Amount of Outstanding Lien.*—If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

Bankruptcy Act, c. 541, 30 Stat. 544:

SEC. 2 [As amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840]. CREATION OF COURTS OF BANKRUPTCY AND THEIR JURISDICTION.—a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * * * *

(20) Exercise ancillary jurisdiction over persons or property within their respective territorial limits in aid of a receiver or trustee ap-

pointed in any bankruptcy proceedings pending in any other court of bankruptcy: *Provided, however,* That the jurisdiction of the ancillary court over a bankrupt's property which it takes into its custody shall not extend beyond preserving such property and, where necessary, conducting the business of the bankrupt, and reducing the property to money, paying therefrom such liens as the court shall find valid and the expenses of ancillary administration, and transmitting the property or its proceeds to the court of primary jurisdiction * * *.

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(11 U.S.C. 11.)

SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.

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j [As amended by Sec. 14(a), Act of July 7, 1952, c. 579, 66 Stat. 420]. Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.

* * * * *

(11 U.S.C. 93.)

SEC. 64 [As amended by Sec. 1, Act of June 22, 1938, *supra*, and Sec. 19(a), Act of July 7, 1952, *supra*]. DEBTS WHICH HAVE PRIORITY.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * * (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the

proceeding, * * * (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, * * * the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [sic] entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however*, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

* * * * *

(11 U.S.C. 104).

SEC. 67 [As amended by Sec. 1, Act of June 22, 1938, *supra*, and Sec. 21(c) and (d), Act of July 7, 1952, *supra*]. LIENS AND FRAUDULENT TRANSFERS.— * * *

b. The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or to any State or any subdivi-

sion thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition initiating a proceeding under this Act, and except where the estate of the bankrupt is solvent: (1) though valid against the trustee under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or any subdivision thereof, on personal property not accompanied by possession of such property, and liens, whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act; and (2) the provisions of subdivision b of this section to the contrary notwithstanding, statutory liens created or recognized by the laws of any State for debts owing to any person, including any State or any subdivision thereof, on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such prop-

erty, shall not be valid against the trustee: *Provided, however,* That so much of clause (1) of this subdivision c as restricts liens for wages and rent and clause (2) of this subdivision c shall not apply in proceedings under chapter X of this Act, unless an order shall be entered therein directing that bankruptcy be proceeded with, or in proceedings under section 77 of this Act. The court may on due notice order so much of any lien in excess of the restricted amount under clause (1) and any lien invalid under clause (2) of this subdivision c to be preserved for the benefit of the estate and, in any such event, such lien for the excess and such invalid lien, as the case may be, shall pass to the trustee.

* * * * *

(11 U.S.C. 107.)

SEC. 70 [As amended by Sec. 23 (a) and (e), Act of July 7, 1952, *supra*]. TITLE TO PROPERTY.

a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located * * *

* * * * *

c. The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the

bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

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(11 U.S.C. 110.)

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